

**SUPPLEMENT TO OFFICIAL STATEMENT
DATED OCTOBER 28, 1999
with respect to**

**\$60,000,000
STATE OF CALIFORNIA
VETERANS GENERAL OBLIGATION BONDS
SERIES BJ7/8 (AMT)**

On page 8 of the captioned Official Statement, in clause (ii) of the first paragraph under the subheading "Special Redemption from Unexpended Proceeds and Excess Revenues," the word "Offered" incorrectly appeared. Clause (ii) should read as follows: "(ii) Excess Revenues (as defined below) derived from any Veterans G.O. Bonds and any Revenue Bonds."

THE DATE OF THIS SUPPLEMENT IS NOVEMBER 5, 1999

**REMARKETING
BOOK-ENTRY ONLY**

**RATINGS: Moody's: Aaa
S&P: AAA
Fitch: AAA
(See "RATINGS" herein)**

In the opinion of Counsel, interest on the Offered Veterans G.O. Bonds is excluded from gross income for federal income tax purposes and is exempt from State of California personal income taxes and interest on the Offered Veterans G.O. Bonds is a specific preference item for purposes of calculating the federal individual and corporate alternative minimum taxes. See "TAX MATTERS" herein.

**\$60,000,000
STATE OF CALIFORNIA
VETERANS GENERAL OBLIGATION BONDS
SERIES BJ 7/8 (AMT)**

**Dated: December 29, 1997
(Interest accruing from December 1, 1999)**

Due: December 1, as shown below

This offering consists of Veterans General Obligation Bonds, Series BJ 7/8 (the "Offered Veterans G.O. Bonds") authorized by the voters of the State of California.

Interest accrues from December 1, 1999 and is payable on June 1 and December 1 of each year, commencing June 1, 2000. The Offered Veterans G.O. Bonds may be purchased in book-entry form only, in the principal amount of \$5,000 or any integral multiples thereof. See APPENDIX C—"BOOK-ENTRY SYSTEM." The Offered Veterans G.O. Bonds are subject to redemption prior to maturity, including redemption at par. See "THE OFFERED VETERANS G.O. BONDS."

The Offered Veterans G.O. Bonds are general obligations of the State to which the full faith and credit of the State are pledged. Principal of, premium, if any, and interest on the Offered Veterans G.O. Bonds are payable from any moneys in the General Fund of the State, subject only to the prior application of such moneys to the support of the public school systems and public institutions of higher education. State law requires funds for the payment of debt service on the Offered Veterans G.O. Bonds to be transferred to the General Fund from the Veterans Farm and Home Building Fund of 1943. See "AUTHORIZATION OF AND SECURITY FOR THE OFFERED VETERANS G.O. BONDS—Security and Payment of Veterans G.O. Bonds."

Payment of the principal of and interest on the Offered Veterans G.O. Bonds when due will be insured by a municipal bond insurance policy to be issued by Ambac Assurance Corporation simultaneously with the delivery of the Offered Veterans G.O. Bonds.

Ambac

This cover page contains certain information for quick reference only. It is not a summary of this issue. Investors must read the entire Official Statement to obtain information essential to the making of an informed investment decision.

**MATURITIES, PRINCIPAL AMOUNTS, INTEREST RATES AND PRICES
\$9,840,000 Serial Veterans G.O. Bonds**

Maturity Date (Dec. 1)	Principal Amount	Interest Rate	CUSIP Number	Maturity Date (Dec. 1)	Principal Amount	Interest Rate	CUSIP Number
2002	\$20,000	4.300%	130629NU8	2010	\$ 20,000	5.375%	130629PC6
2003	20,000	4.500	130629NV6	2011	1,280,000	5.500	130629PD4
2004	20,000	4.600	130629NW4	2012	1,495,000	5.625	130629PE2
2005	20,000	4.750	130629NX2	2013	1,580,000	5.750	130629PF9
2006	20,000	4.900	130629NY0	2014	1,670,000	5.850	130629PG7
2007	20,000	5.050	130629NZ7	2015	1,765,000	5.950	130629PH5
2008	20,000	5.150	130629PA0	2016	1,870,000	6.000	130629PJ1
2009	20,000	5.250	130629PB8				

\$4,080,000 6.10% Term Veterans G.O. Bonds due December 1, 2018—CUSIP No. 130629PK8

\$15,420,000 6.15% Term Veterans G.O. Bonds due December 1, 2024—CUSIP No. 130629PL6

\$30,660,000 6.20% Term Veterans G.O. Bonds due December 1, 2032—CUSIP No. 130629PM4

Price of all Offered Veterans G.O. Bonds—100%

The remarketing of the Offered Veterans G.O. Bonds is subject to certain conditions, including the receipt of certain legal opinions of The Honorable Bill Lockyer, Attorney General, and of Hawkins, Delafield & Wood, Bond Counsel to the State. Certain legal matters will be passed upon by Lofton De Lancie, Disclosure Counsel to the State. Certain legal matters will be passed upon for the Underwriters by their counsel, Kutak Rock. Public Resources Advisory Group has served as Financial Advisor in connection with the remarketing of the Offered Veterans G.O. Bonds. The Offered Veterans G.O. Bonds will be available for delivery on or about December 1, 1999.

HONORABLE PHILIP ANGELIDES
Treasurer of the State of California

Lehman Brothers

**Bear, Stearns & Co. Inc.
Dain Rauscher Incorporated
JP Morgan & Co.**

**Fleet Securities, Inc.
M.R. Beal & Company
Salomon Smith Barney**

**Merrill Lynch & Co.
Great Pacific Securities, Inc.
Roberts & Ryan Investments, Inc.**

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Copies of this Official Statement may be obtained from:

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\$60,000,000
STATE OF CALIFORNIA
VETERANS GENERAL OBLIGATION BONDS
SERIES BJ 7/8 (AMT)

INTRODUCTION

This introduction is a brief summary of the terms of the State of California Veterans General Obligation Bonds, Series BJ 7/8 (the "Offered Veterans G.O. Bonds") and a brief description of the Official Statement; a full review should be made of the entire Official Statement. All statements contained in this introduction are qualified in their entirety by reference to the entire Official Statement. Summaries of provisions of the Constitution and other laws of the State of California or of any other documents referred to in this Official Statement do not purport to be complete and such summaries are qualified in their entirety by references to the complete provisions.

Description of the Offered Veterans G.O. Bonds

The issuance of veterans general obligation bonds ("Veterans G.O. Bonds") is authorized by Bond Acts (defined below) approved by the voters of the State of California (the "State") and by resolutions of the Veterans Finance Committee of 1943. The Offered Veterans G.O. Bonds are authorized by specific Bond Acts and have been issued to finance or refinance obligations issued to finance the purchase of homes and farms for California military veterans under the Farm and Home Purchase Program (the "Program") of the State Department of Veterans Affairs (the "Department"). The Offered Veterans G.O. Bonds being remarketed are a portion of the State of California Veterans General Obligation Bonds, Series BJ 3/4 (the "Series BJ Bonds") issued in December 1997. The Offered Veterans G.O. Bonds are being remarketed with fixed interest rates to their respective maturities to new Bondholders in connection with a mandatory tender on December 1, 1999 by existing Bondholders. The remaining portion of the Series BJ Bonds will continue to bear interest at short term rates until their applicable tender date. See "THE OFFERED VETERANS G.O. BONDS—Identification and Authorization of the Offered Veterans G.O. Bonds."

The Offered Veterans G.O. Bonds will be registered in the name of a nominee of The Depository Trust Company ("DTC") which will act as securities depository for the Offered Veterans G.O. Bonds. Purchases of beneficial interests in the Offered Veterans G.O. Bond may be in book-entry form only, in the principal amount of \$5,000 or any integral multiple thereof. Principal and interest are payable as specified on the front cover page of this Official Statement.

Security and Sources of Payment for Veterans G.O. Bonds

The Veterans G.O. Bonds are general obligations of the State to which the full faith and credit of the State are pledged (see "AUTHORIZATION OF AND SECURITY FOR THE OFFERED VETERANS G.O. BONDS—Security and Payment of Veterans G.O. Bonds" below). Principal of and interest on the Veterans G.O. Bonds are payable from moneys in the General Fund of the State Treasury (the "General Fund") (see APPENDIX A—"THE STATE OF CALIFORNIA—State Finances—The General Fund"), subject only to the prior application of moneys in the General

Fund to the support of the public school system and public institutions of higher education. The Bond Acts authorizing the Veterans G.O. Bonds provide that the State shall collect annually, in the same manner and at the same time as it collects other State revenues, a sum sufficient, in addition to the ordinary revenues of the State, to pay the principal of and interest on the Veterans G.O. Bonds. State law requires funds for the payment of debt service on the Veterans G.O. Bonds to be transferred to the General Fund from the Veterans Farm and Home Building Fund of 1943 (the "1943 Fund"). See "AUTHORIZATION OF AND SECURITY FOR THE VETERANS G.O. BONDS—Security and Payment of Veterans G.O. Bonds" and APPENDIX B—"THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND."

Redemption

The Offered Veterans G.O. Bonds are subject to optional and special redemption prior to maturity. In addition, the Offered Veterans G.O. Bonds maturing on December 1, 2018, December 1, 2024 and December 1, 2032, respectively, are subject to mandatory redemption at par prior to their stated maturities, in part, from sinking fund payments made by the State. See "THE OFFERED VETERANS G.O. BONDS—Redemption."

Information Related to this Official Statement

The information set forth herein has been obtained from official sources which are believed to be reliable, but it is not guaranteed as to accuracy or completeness. The information and expressions of opinion herein are subject to change without notice, and neither delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the State since the date hereof.

All financial and other information presented in this Official Statement has been provided by, respectively, the State or the Department from its records, except for information expressly attributed to other sources. The presentation of information, including tables of receipts from taxes and other revenues, is intended to show recent historic information and is not intended to indicate future or continuing trends in the financial position or other affairs of, respectively, the State or the Department. No representation is made that past experience, as it might be shown by financial and other information, will necessarily continue or be repeated in the future.

This Official Statement is not to be construed as a contract with the purchasers of the Offered Veterans G.O. Bonds. Statements contained in this Official Statement which involve estimates, forecasts or matters of opinion, whether or not expressly so described herein, are intended solely as such and are not to be construed as representations of facts.

This Official Statement does not constitute an offer to sell or the solicitation of an offer to buy, nor shall there be any sale of the Offered Veterans G.O. Bonds, by any person in any jurisdiction in which it is unlawful for such person to make such an offer, solicitation or sale.

No dealer, broker, salesperson or other person has been authorized by the State to give any information or to make any representations other than those contained herein and, if given or made, such other information or representations must not be relied upon as having been authorized by the State.

IN CONNECTION WITH THIS OFFERING THE UNDERWRITERS MAY OVERALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICES OF THE OFFERED VETERANS G.O. BONDS OFFERED HEREBY AT LEVELS ABOVE THOSE WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

Tax Matters

In the opinion of The Honorable Bill Lockyer, Attorney General of the State of California (the "Attorney General") and Hawkins, Delafield & Wood, Bond Counsel to the State ("Bond Counsel"), assuming compliance by the State and the Department with certain tax covenants described herein, the interest on the Offered Veterans G.O. Bonds is not included in gross income for federal income tax purposes under existing statutes and court decisions, and the interest on the Offered Veterans G.O. Bonds is exempt from personal income taxes of the State of California under present State law. The Attorney General and Bond Counsel are of the further opinion that interest on the Offered Veterans G.O. Bonds is treated as a preference item for purposes of calculating the alternate minimum tax imposed under the Internal Revenue Code of 1986, as amended (the "Federal Tax Code"), with respect to individuals and corporations. See "TAX MATTERS" below and APPENDIX E—"PROPOSED FORM OF LEGAL OPINION."

Continuing Disclosure

The State Treasurer, on behalf of the State, will provide annually to certain nationally recognized municipal securities information repositories certain financial information and operating data relating to the State for each Fiscal Year in which any Offered Veterans G.O. Bonds are outstanding (the "Treasurer's Annual Report"), by not later than April 1 of the calendar year following the end of such Fiscal Year, commencing with the report for the 1998-99 Fiscal Year, and to provide notices of the occurrence of certain other enumerated events if material. The Secretary of the Department will provide annually to certain nationally recognized municipal securities information repositories certain financial information and operating data relating to the program for each Fiscal Year in which any Offered Veterans G.O. Bonds are outstanding (the "Department's Annual Report"), by not later than April 1 of the calendar year following the end of such Fiscal Year, commencing with the report for the 1998-1999 Fiscal Year. The specific nature of the information to be contained in the Treasurer's Annual Report and the Department's Annual Report or the notices of material events and certain other terms of the continuing disclosure obligations are summarized below under APPENDIX D—"SUMMARY OF CONTINUING DISCLOSURE CERTIFICATES."

Neither the State Treasurer nor the Secretary of the Department has failed to comply, in any material respect, with any "previous undertakings," as that term is used in Rule 15c2-12 promulgated under the Securities Exchange Act of 1934.

Additional Information

Questions regarding this Official Statement and the issuance of these securities may be addressed to the office of the Honorable Philip Angelides, Treasurer of the State of California, P.O. Box 942809, Sacramento, California 94209-0001, telephone (800) 900-3873. Questions regarding the Program should be addressed to the Bond Finance Division of the Department of Veterans Affairs, P.O. Box 942895, Sacramento, California 94295-0001, telephone (916) 653-2081.

AUTHORIZATION OF AND SECURITY FOR THE OFFERED VETERANS G.O. BONDS

Authorization

Each general obligation bond act authorizing the issuance of Veterans G.O. Bonds (each, a "Bond Act") incorporates by reference the State General Obligation Bond Law (the "Law"), which is set forth in Chapter 4 (commencing with Section 16720) of Part 3 of Division 4 of Title 2 of the California Government Code. The Law provides a procedure for the authorization, sale, issuance, use of proceeds, repayment and refunding of State general obligation bonds.

Security and Payment of Veterans G.O. Bonds

The Veterans G.O. Bonds are general obligations of the State, payable in accordance with the Bond Acts out of the General Fund. The full faith and credit of the State are pledged for the punctual payment of principal of and interest on the Veterans G.O. Bonds. The Bond Acts provide that the State shall collect annually in the same manner and at the same time as it collects other State revenue an amount sufficient in addition to the ordinary revenue of the State, to pay principal of and interest on the Veterans G.O. Bonds. Each Bond Act also contains a continuing appropriation from the General Fund of the sum annually necessary to pay principal of and interest on the Veterans G.O. Bonds. Payment of principal, premium, if any, and interest on the Veterans G.O. Bonds from the General Fund is subject only to the prior application of moneys in the General Fund to the support of the public school system and public institutions of higher education.

The Department's principal fund is the 1943 Fund described in APPENDIX B—"THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND—The 1943 Fund." The Military and Veterans Code of the State (the "Veterans Code"), of which the Bond Acts are a part, requires that on the dates when funds are to be remitted to Bondowners for the payment of debt service on Veterans G.O. Bonds in each fiscal year, there shall be transferred to the General Fund to pay the debt service on Veterans G.O. Bonds all of the money in the 1943 Fund (but not in excess of the amount of debt service then due and payable). If the money so transferred on the remittance dates is less than the debt service then due and payable, the balance remaining unpaid is required by the Veterans Code to be transferred to the General Fund out of the 1943 Fund as soon as it shall become available,

together with interest thereon from the remittance date until paid, at the same rate of interest as borne by the applicable Veterans G.O. Bonds, compounded semiannually.

The Veterans Code does not grant any lien on the 1943 Fund or the moneys therein to the holders of any Veterans G.O. Bonds. Outstanding home purchase revenue bonds in the aggregate principal amount of \$404,215,000 (as of June 30, 1999) previously issued by the Department and any additional home purchase revenue bonds issued by the Department in the future (collectively, the "Revenue Bonds") are and will be special obligations of the Department payable solely from, and secured by a pledge of, an undivided interest in the assets of the 1943 Fund (other than proceeds of Veterans G.O. Bonds or any amounts in any rebate account) and any reserve accounts established for the benefit of Revenue Bonds. The Veterans Code provides that this undivided interest in the 1943 Fund is secondary and subordinate to any interest or right in the assets of the 1943 Fund of the people of the State and of the holders of the Veterans G.O. Bonds (that is, the right to payment or reimbursements of debt service on Veterans G.O. Bonds described in the preceding paragraph). If debt service payments to the General Fund are current and all reimbursement of debt service payments with interest as described in the preceding paragraph have been made, no holder or beneficial owner of Veterans G.O. Bonds has any right to restrict disbursements by the Department from the 1943 Fund for any lawful purpose, including payment of debt service on or redemptions and purchases of Revenue Bonds.

While the Department's 1998 Financial Statement for the 1943 Fund reflected an increase in retained earnings, the Department's 1999 Financial Statement for the 1943 Fund reflected a loss in retained earnings. In addition, the Program has experienced significant losses during other recent fiscal years, which have caused decreases in the retained earnings in the 1943 Fund. For additional information, see APPENDIX B—"THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND—The 1943 Fund" and Exhibit 1 to APPENDIX B—"Department Audited Financial Statements."

The Offered Veterans G.O. Bonds are the subject of a Municipal Bond Insurance Policy to be issued by Ambac Assurance Corporation. See "MUNICIPAL BOND INSURANCE POLICY."

THE OFFERED VETERANS G.O. BONDS

General

The Offered Veterans G.O. Bonds are or will be registered in the name of nominee of The Depository Trust Company ("DTC"), which will act as securities depository for the Offered Veterans G.O. Bonds. Purchases of beneficial interests in the Offered Veterans G.O. Bonds may be made in book-entry form only, in the principal amount of \$5,000 or any integral multiple thereof. See APPENDIX C—"BOOK-ENTRY SYSTEM."

The Offered Veterans G.O. Bonds are or will be dated the applicable date, and will mature on the dates and in the amounts, set forth on the front cover page hereof. Interest will accrue from December 1, 1999 and is payable on June 1 and December 1 in each year (each, an "Interest Payment Date"), commencing on June 1, 2000, at the respective rates shown on the

front cover page of this Official Statement. Interest on the Offered Veterans G.O. Bonds shall be calculated on the basis of a 360-day year comprised of twelve thirty-day months.

Principal and interest are payable directly to DTC by the State Treasurer. Upon receipt of payments of principal and interest, DTC is to in turn remit such principal and interest to the participants in DTC for disbursements to the beneficial owners of the Offered Veterans G.O. Bonds. The record date for the payment of interest on the Offered Veterans G.O. Bonds is the close of business on the 15th day of the month immediately preceding an Interest Payment Date, whether or not the day is a business day.

Purpose

Under the Program, the Department acquires residential property to be sold to eligible veterans under contracts of purchase between the Department and such veterans ("Contracts of Purchase"). Such acquisition is financed principally with the proceeds of Veterans G.O. Bonds and the Department's Revenue Bonds.

The Offered Veterans G.O. Bonds being remarketed were issued on December 29, 1997, currently bear interest at a short-term rate and are subject to mandatory tender and remarketing on December 1, 1999. Upon remarketing, each such remarketed Offered Veterans G.O. Bond will bear interest at a fixed interest rate to its respective stated maturity or earlier redemption.

The proceeds of the remarketed Offered Veterans G.O. Bonds will become available to finance new Contracts of Purchase. These available moneys will be in addition to moneys also made available to finance new Contracts of Purchase through the issuance of the Department's Revenue Bonds and other Veterans G.O. Bonds in 1997, 1998 and earlier in 1999. See APPENDIX B—"THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND—Exhibit 2—Certain Department Financial Information and Operating Data—Contracts of Purchase—Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments."

Identification and Authorization of the Offered Veterans G.O. Bonds

The Offered Veterans G.O. Bonds were issued under two Bond Acts, each authorized by the voters, as described below, for the purpose of financing new Contracts of Purchase when the short-term interest rate borne by such bonds is adjusted to fixed interest rates to maturity.

Authorization

1. \$13,920,000 principal amount of Veterans General Obligation Bonds, Series BJ7, authorized under the Veterans Bond Act of 1988 (AMT);
2. \$46,080,000 principal amount of Veterans General Obligation Bonds, Series BJ8, authorized under the Veterans Bond Act of 1990 (AMT);

Redemption

Sinking Fund Redemption

The Offered Veterans G.O. Bonds maturing on December 1, 2018, December 1, 2024 and December 1, 2032, respectively (the "Term Bonds") are subject to redemption prior to their respective stated maturity dates, in part, by lot, from sinking fund payments, at a redemption price of 100 percent of the principal amount thereof, plus accrued interest to the date fixed for redemption, without premium, on the respective dates and in the respective amounts shown below.

SINKING FUND REDEMPTION SCHEDULE

<u>Date</u> <u>(December 1)</u>	<u>Bonds Maturing</u> <u>December 1, 2018</u>	<u>Bonds Maturing</u> <u>December 1, 2024</u>	<u>Bonds Maturing</u> <u>December 1, 2032</u>
2017	\$1,985,000		
2018	2,095,000†		
2019		\$2,220,000	
2020		2,350,000	
2021		2,485,000	
2022		2,630,000	
2023		2,790,000	
2024		2,945,000†	
2025			\$3,115,000
2026			3,300,000
2027			3,490,000
2028			3,700,000
2029			3,910,000
2030			4,135,000
2031			4,375,000
2032			4,635,000†

† Maturity.

If less than all of the Term Bonds of the same maturity date are purchased or called for redemption (other than in satisfaction of sinking fund payments), the State Treasurer will credit the principal amount of such Term Bonds that are so purchased or redeemed against applicable remaining sinking fund payments relating to such Term Bonds (including the principal amounts due on the respective maturity dates, as shown above), as requested by the Department.

Optional Redemption

The Offered Veterans G.O. Bonds maturing on December 1 of the years 2010 through and including 2016 are subject to optional redemption prior to their respective stated maturity dates, at the option of the State upon request of the Department, in whole or in part (of any maturity and by lot within each maturity), on any date on or after December 1, 2009 at the redemption prices stated below, plus accrued interest to the date fixed for redemption:

<u>Redemption Dates</u> <u>(both dates inclusive)</u>	<u>Redemption Price</u> <u>(as percentage of principal</u> <u>amount redeemed)</u>
December 1, 2009 to November 30, 2010	101%
December 1, 2010 and thereafter	100

The Term Bonds (those Offered Veterans G.O. Bonds maturing on December 1 of the years 2018, 2024 and 2032, respectively) are subject to optional redemption prior to their respective stated maturity dates, at the option of the State upon request of the Department, in whole or in part (of any maturity and by lot within each maturity), on any date on or after December 1, 2005 at the redemption prices stated below, plus accrued interest to the date fixed for redemption:

<u>Redemption Dates</u> <u>(both dates inclusive)</u>	<u>Redemption Price</u> <u>(as percentage of principal</u> <u>amount redeemed)</u>
December 1, 2005 to November 30, 2006	102%
December 1, 2006 to November 30, 2007	101
December 1, 2007 and thereafter	100

Special Redemption from Unexpended Proceeds and Excess Revenues

The Offered Veterans G.O. Bonds are also subject to special redemption prior to their respective stated maturity dates, at the option of the State upon request of the Department, from (i) moneys deposited in the related Series Proceeds Subaccount with respect to the Offered Veterans G.O. Bonds on the date of issuance of such bonds that have not been applied to finance Contracts of Purchase and (ii) Excess Revenues (as defined below) derived from any Offered Veterans G.O. Bonds and any Revenue Bonds. Any such redemption may be on any date, in whole or in part (and of any maturity at the option of the State upon request of the Department, and by lot within such maturity), at the principal amount thereof plus accrued interest to the date fixed for redemption, without premium.

Moneys are currently available through the issuance of Veterans G.O. Bonds and Revenue Bonds to finance Contracts of Purchase, and additional moneys may become available to finance Contracts of Purchase through the future issuances of Revenue Bonds and Veterans G.O. Bonds. Since the Department has full discretion, subject to eligibility requirements and the requirements of the Internal Revenue Code of 1954, as amended, and the Internal Revenue Code of 1986, as

amended (collectively, the "Federal Tax Code"), in applying the proceeds of all of these bonds to finance the Program, the proceeds of prior and future bonds may be used to finance Contracts of Purchase before proceeds of the Offered Veterans G.O. Bonds.

Although the Department's goal is to use moneys made available through the issuance of the Offered Veterans G.O. Bonds (including recycled prepayments) to finance Contracts of Purchase, such expectation is subject to change, and such moneys or prepayments would then be available to redeem Offered Veterans G.O. Bonds, other Veterans G.O. Bonds, and Revenue Bonds. See "THE OFFERED VETERANS G.O. BONDS-Purpose."

Excess Revenues can include prepayments and repayments on Contracts of Purchase funded by Revenue Bonds and Veterans G.O. Bonds, and also includes Revenues which had been set aside to be recycled into new Contracts of Purchase. All payments on Contracts of Purchase are deposited in the 1943 Fund and applied to pay or reimburse debt service on the Veterans G.O. Bonds, to pay debt service on Revenue Bonds, to pay for mandatory redemptions of Veterans G.O. Bonds and Revenue Bonds, to pay Program and Department expenses, and to pay certain insurance claims. The Department, subject to applicable bond authorizing resolutions, may apply Excess Revenues to redeem any Veterans G.O. Bonds or Revenue Bonds eligible for redemption. The Department's decision to apply Excess Revenues to redeem bonds, to finance new Contracts of Purchase, or for any other permitted purpose depends on many factors, including applicable bond authorizing resolution requirements, demand for Contracts of Purchase, debt service cost savings, investment earnings, and Federal Tax Code requirements.

Certain of the outstanding Veterans G.O. Bonds are not subject to redemption prior to maturity. See Exhibit 2 to APPENDIX B—"THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND—Certain Department Financial Information and Operating Data."

"Excess Revenues" means, as of any date of calculation, Revenues in excess of Accrued Debt Service. See APPENDIX B—"THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND—The 1943 Fund—Excess Revenues."

Notice of Redemption

When redemption is required while the Offered Veterans G.O. Bonds are in book-entry only form, the State Treasurer shall give notice of redemption by mailing copies of such notice only to DTC (not to the beneficial owners of the Offered Veterans G.O. Bonds) not less than thirty or more than sixty days prior to the date fixed for redemption. DTC, in turn, is to send the notice of redemption to its participants for distribution to the beneficial owners of the Offered Veterans G.O. Bonds. See APPENDIX C—"BOOK-ENTRY SYSTEM." The notice will state, among other things, that the Offered Veterans G.O. Bonds or a designated portion thereof (in the case of redemption of an Offered Veterans G.O. Bond in part but not in whole) are to be redeemed, the dated date of the Offered Veterans G.O. Bonds, the redemption date, the Series and maturities of the Offered Veterans G.O. Bonds to be redeemed and the redemption price. The notice will also state that after the date fixed for redemption, no further interest will accrue on the principal of any Offered Veterans G.O. Bonds called for redemption. Notice of

redemption will also be provided by mail to certain financial services and securities depository services.

New York Stock Exchange Listing

The State Treasurer expects to list the Term Bonds maturing on December 1, 2024 and December 1, 2032 on the New York Stock Exchange. There can be no assurance that such Term Bonds will be listed or will continue to be listed for the duration of the time they will be outstanding.

MUNICIPAL BOND INSURANCE POLICY

The following information concerning Ambac Assurance Corporation ("Ambac Assurance") and the Municipal Bond Insurance Policy has been furnished by Ambac Assurance for use in this Official Statement, and has not been independently certified or verified by the State, the Department or the Underwriters. No representation is made by the State, the Department or the Underwriters as to the accuracy, completeness or adequacy of such information or as to the absence of material adverse changes in the condition of Ambac Assurance subsequent to the date of this Official Statement. Reference is made to APPENDIX F for a specimen of the Municipal Bond Insurance Policy.

Payment Pursuant to Municipal Bond Insurance Policy

Ambac Assurance has made a commitment to issue a municipal bond insurance policy (the "Municipal Bond Insurance Policy" or the "Policy") relating to the Offered Veterans G.O. Bonds effective as of the date of issuance of the Offered Veterans G.O. Bonds. Under the terms of the Municipal Bond Insurance Policy, Ambac Assurance will pay to the United States Trust Company of New York, in New York, New York or any successor thereto (the "Insurance Trustee") that portion of the principal of and interest on the Offered Veterans G.O. Bonds which shall become Due for Payment but shall be unpaid by reason of Nonpayment by the Issuer (as such terms are defined in the Municipal Bond Insurance Policy). Ambac Assurance will make such payments to the Insurance Trustee on the later of the date on which such principal and interest becomes Due for Payment or within one business day following the date on which Ambac Assurance shall have received notice of Nonpayment from the State Treasurer. The insurance will extend for the term of the Offered Veterans G.O. Bonds and, once issued, cannot be canceled by Ambac Assurance.

The Municipal Bond Insurance Policy will insure payment only on stated maturity dates and on mandatory sinking fund installment dates, in the case of principal, and on stated dates for payment, in the case of interest. If the Offered Veterans G.O. Bonds become subject to mandatory redemption and insufficient funds are available for redemption of all outstanding Offered Veterans G.O. Bonds, Ambac Assurance will remain obligated to pay principal of and interest on outstanding Offered Veterans G.O. Bonds on the originally scheduled interest and principal payment dates including mandatory sinking fund redemption dates. In the event of any acceleration of the principal of the Offered Veterans G.O. Bonds, the insured payments will be

made at such times and in such amounts as would have been made had there not been an acceleration.

In the event the State Treasurer has notice that any payment of principal or interest on an Offered Veterans G.O. Bond which has become Due for Payment and which is made to an owner of Offered Veterans G.O. Bonds (a "Bondholder") by or on behalf of the State has been deemed a preferential transfer and theretofore recovered from its registered owner pursuant to the United States Bankruptcy Code in accordance with a final, nonappealable order of a court of competent jurisdiction, such registered owner will be entitled to payment from Ambac Assurance to the extent of such recovery if sufficient funds are not otherwise available.

The Municipal Bond Insurance Policy does **not** insure any risk other than Nonpayment, as defined in the Policy. Specifically, the Municipal Bond Insurance Policy does **not** cover:

1. payment on acceleration, as a result of a call for redemption (other than mandatory sinking fund redemption) or as a result of any other advancement of maturity.
2. payment of any redemption, prepayment or acceleration premium.
3. nonpayment of principal or interest caused by the insolvency or negligence of the State Treasurer or of any Trustee or Paying Agent, if any.

If it becomes necessary to call upon the Municipal Bond Insurance Policy, payment of principal requires surrender of Offered Veterans G.O. Bonds to the Insurance Trustee together with an appropriate instrument of assignment so as to permit ownership of such Offered Veterans G.O. Bonds to be registered in the name of Ambac Assurance to the extent of the payment under the Municipal Bond Insurance Policy. Payment of interest pursuant to the Municipal Bond Insurance Policy requires proof of Bondholder entitlement to interest payments and an appropriate assignment of the Bondholder's right to payment to Ambac Assurance.

Upon payment of the insurance benefits, Ambac Assurance will become the owner of the Offered Veterans G.O. Bond, appurtenant coupon, if any, or right to payment of principal or interest on such Offered Veterans G.O. Bond and will be fully subrogated to the surrendering Bondholder's rights to payment.

In the event that Ambac Assurance were to become insolvent, any claims arising under the Policy would be excluded from coverage by the California Insurance Guaranty Association, established pursuant to the laws of the State of California.

Ambac Assurance Corporation

Ambac Assurance Corporation ("Ambac Assurance") is a Wisconsin-domiciled stock insurance corporation regulated by the Office of the Commissioner of Insurance of the State of Wisconsin and licensed to do business in 50 states, the District of Columbia, the Territory of Guam and the Commonwealth of Puerto Rico, with admitted assets of approximately \$3,573,000,000 (unaudited) and statutory capital of approximately \$2,139,000,000 (unaudited)

as of June 30, 1999. Statutory capital consists of Ambac Assurance's policyholders' surplus and statutory contingency reserve. Standard & Poor's Ratings Services, a Division of The McGraw-Hill Companies, Moody's Investors Service and Fitch IBCA, Inc. have each assigned a triple-A financial strength rating to Ambac Assurance.

Ambac Assurance has obtained a ruling from the Internal Revenue Service to the effect that the insuring of an obligation by Ambac Assurance will not affect the treatment for federal income tax purposes of interest on such obligation and that insurance proceeds representing maturing interest paid by Ambac Assurance under policy provisions substantially identical to those contained in its municipal bond insurance policy shall be treated for federal income tax purposes in the same manner as if such payments were made by the issuer of the Offered Veterans G.O. Bonds.

Ambac Assurance makes no representation regarding the Offered Veterans G.O. Bonds or the advisability of investing in the Offered Veterans G.O. Bonds and makes no representation regarding, nor has it participated in the preparation of, the Official Statement other than the information supplied by Ambac Assurance and presented under the heading "MUNICIPAL BOND INSURANCE POLICY" and in APPENDIX F—"MUNICIPAL BOND INSURANCE POLICY."

Available Information

The parent company of Ambac Assurance, Ambac Financial Group, Inc. (the "Company"), is subject to the informational requirements of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and in accordance therewith files reports, proxy statements and other information with the Securities and Exchange Commission (the "Commission"). Such reports, proxy statements and other information may be inspected and copied at the public reference facilities maintained by the Commission at 450 Fifth Street, N.W., Washington, D.C. 20549 and at the Commission's regional offices at 7 World Trade Center, New York, New York 10048 and Northwestern Atrium Center, 500 West Madison Street, Suite 1400, Chicago, Illinois 60661. Copies of such material can be obtained from the public reference section of the Commission at 450 Fifth Street, N.W., Washington, D.C. 20549 at prescribed rates. In addition, the aforementioned material may also be inspected at the offices of the New York Stock Exchange, Inc. (the "NYSE") at 20 Broad Street, New York, New York 10005. The Company's Common Stock is listed on the NYSE.

Copies of Ambac Assurance's financial statements prepared in accordance with statutory accounting standards are available from Ambac Assurance. The address of Ambac Assurance's administrative offices and its telephone number are One State Street Plaza, 17th Floor, New York, New York, 10004 and (212) 668-0340.

Incorporation of Certain Documents by Reference

The following documents filed by the Company with the Commission (File No. 1-10777) are incorporated by reference in this Official Statement:

1. The Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1998 and filed on March 30, 1999;

2. The Company's Current Report on Form 8-K dated March 24, 1999 and filed on March 24, 1999;

3. The Company's 1999 Proxy Statement dated March 30, 1999 and filed on March 30, 1999;

4. The Company's Quarterly Report on Form 10-Q for the fiscal quarterly period ended March 31, 1999 and filed on May 12, 1999; and

5. The Company's Quarterly Report on Form 10-Q for the fiscal quarterly period ended June 30, 1999 and filed on August 13, 1999.

All documents subsequently filed by the Company pursuant to the requirements of the Exchange Act after the date of this Official Statement will be available for inspection in the same manner as described above in "Available Information".

Year 2000 Readiness Disclosure

The issue commonly known as the Y2K problem ("Y2K") relates to whether computer programs and embedded computer chips will be able to distinguish between the year 1900 and the year 2000. In 1998, the Company commenced an initiative to assess and address any risks posed by the Y2K problem. This initiative was a high priority undertaking and considered crucial to the operation of the Company's businesses. Pursuant to this initiative, the Company assessed the risks to its businesses related to the functionality of its own computer systems and those of third parties. All phases of the initiative have been completed and the Company has substantially addressed any problems brought to light as a result of the initiative.

The initiative was comprised of a three-phase process. Phase I was an inventory analysis and impact assessment. Phase II was the testing phase during which all critical systems were tested, transactions were run through critical systems by applying various permutations and combinations of Y2K sensitive dates, and results were reviewed independently by each business unit. In Phase III, the extent of code repair was determined and remediated. The total cost of identifying, testing and remediating its critical systems was approximately \$1.1 million, \$0.4 million of which was incurred during 1999.

The Company's principal Y2K risks include risk that the Company does not successfully ready its operations for the next century. The Company, like other financial institutions, is heavily dependent upon its computer systems. Y2K problems in the Company's internal systems could result in an interruption in, or failure of, certain normal business activities or operations. Such failures could adversely affect the Company's operations. Although findings indicate that the systems supporting the Company's internal operations will be compliant, management has nevertheless developed contingent procedures in the event its critical systems should fail. These procedures have been approved by the Company's Board of Directors and are in the process of being tested.

Another potential risk is the failure by an obligor of obligations insured by Ambac Assurance and its subsidiaries to make scheduled payment of debt service due to the obligor's Y2K-related systems, thus triggering a claim under an Ambac Assurance insurance policy. In the unlikely event a claim resulting solely from a Y2K problem occurs, the Company would utilize its sources of liquidity to pay claims and has in fact increased liquidity for such purpose. The Company would expect full recovery of such claims when Y2K problems are resolved.

Additional potential risks include the risk of disruption of Company operations due to operational failures of third parties and the risk of Y2K systems-related failure by the trustees or paying agents on transactions insured by Ambac Assurance. This latter risk is mitigated by the fact that Ambac Assurance's obligation to pay claims is related to the creditworthiness of the issuer and not the trustee.

More complete year 2000 disclosure for the Company is set forth in the Company's Quarterly Report on Form 10-Q for the fiscal quarterly period ended June 30, 1999 and filed with the Securities and Exchange Commission on August 13, 1999. Such information is specifically incorporated by reference herein.

No assurance is made regarding the ultimate outcome of the Company's plan, and external failures (such as failures affecting securities exchanges or funds and securities clearing organizations) could have a material adverse impact on the operations of the Company and its subsidiaries, including Ambac Assurance.

TAX MATTERS

Federal Tax Matters

The Offered Veterans G.O. Bonds are part of a single issue for federal income tax purposes with certain outstanding Veterans G.O. Bonds and Revenue Bonds issued in 1997 and 1998 (the "1997/1998 Tax Plan Bonds"). The requirements of applicable federal tax law must be satisfied with respect to the Offered Veterans G.O. Bonds and all such other outstanding Veterans G.O. Bonds and Revenue Bonds in order that interest on the Offered Veterans G.O. Bonds not be included in gross income for federal income tax purposes retroactive to the date of issuance thereof.

Loan Eligibility Requirements Imposed by the Federal Tax Code

The Federal Tax Code contains the following loan eligibility requirements which are applicable (with certain exceptions), in whole or in part, to Contracts of Purchase (or portions of Contracts of Purchase) entered into with respect to properties acquired with amounts allocable to qualified veterans' mortgage bonds (the "QVMB Contracts") and/or to qualified mortgage bonds (the "QMB Contracts"). The Offered Veterans G.O. Bonds and the other 1997/1998 Tax Plan Bonds are qualified veterans' mortgage bonds and not qualified mortgage bonds and the Revenue Bonds that are 1997/1998 Tax Plan Bonds are qualified mortgage bonds and not qualified veterans' mortgage bonds.

Residence Requirement. The Federal Tax Code requires that each of the premises financed with proceeds of qualified veterans' mortgage bonds or qualified mortgage bonds be a one-to-four family residence, one unit of which can reasonably be expected to become the principal residence of the veteran within a reasonable time after the financing is provided. Certain documents adopted by the Department establish procedures to be followed in connection with QVMB Contracts and QMB Contracts which finance the acquisition of single family homes in order to assure that interest paid on the Offered Veterans G.O. Bonds, and the other 1997/1998 Tax Plan Bonds, not be included in gross income for federal income tax purposes under the Federal Tax Code (the "Veterans Program Documents"). Certain documents adopted by the Department establish procedures to be followed in connection with QVMB Contracts and QMB Contracts to finance home improvement loans in order to assure that interest paid on the Offered Veterans G.O. Bonds, and the other 1997/1998 Tax Plan Bonds, is not included in gross income for federal income tax purposes under the Federal Tax Code (the "Home Improvement Program Documents"; together with the Veterans Program Documents, the "Program Documents"). In connection with the financing of a QVMB Contract or a QMB Contract, the Program Documents require that each veteran submit an affidavit stating such person's intention to occupy the premises as his principal residence within 60 days after closing of the QVMB Contract or QMB Contract.

Qualified Veteran Requirement. The Federal Tax Code requires that each mortgagor to whom financing is provided under a qualified veterans' mortgage bond issue have served on active duty at some time before January 1, 1977 and apply or have applied for financing before the later of January 31, 1985 or the date which is 30 years after the last date on which the veteran left active service. The Department has established procedures and has covenanted to comply with such requirement.

New Mortgage Requirement. The Federal Tax Code requires that, with certain limited exceptions, the lendable proceeds of qualified veterans' mortgage bonds and qualified mortgage bonds finance new mortgage loans only and that no proceeds may be used to acquire or replace an existing mortgage loan, which would include the refinancing of a pre-existing mortgage loan. The Program Documents provide that the Department will verify compliance with the new mortgage requirement by requiring each veteran to certify prior to financing, subject to such exceptions, that no refinancing of a prior mortgage loan is being effected.

Qualified Home Improvement Loans. The Federal Tax Code requires that a home improvement loan financed with the lendable proceeds of qualified veterans mortgage bonds or qualified mortgage bonds be made only with respect to an owner-occupied residence, and finance alternations, repairs, and improvements on or in connection with an existing one-to-four family residence by the owner thereof, but only if such alterations, repairs and improvements substantially protect or improve the basic livability or energy efficiency of the property. The Program Documents establish procedures to comply with such requirement.

First-Time Homebuyer Requirement. The Federal Tax Code requires that, subject to certain exceptions, the lendable proceeds of qualified mortgage bonds be used to provide financing to borrowers who have not had a present ownership interest in their principal residence during the three-year period prior to execution of the mortgage loan. This limitation, however, does not apply to the mortgagor's interest in the residence being financed or to certain residences

in certain Presidentially-declared disaster areas; and all financing with respect to targeted area residences and residences on land possessed under certain contract for deed agreements is treated as satisfying the first-time homebuyer requirement. The Department verifies compliance with the first-time homebuyer requirement by having veterans subject to this requirement so certify when applying for a new Contract of Purchase, and the Program Documents require that a reasonable investigation be made to verify such certification. Veterans subject to this requirement are required to provide federal income tax returns for the previous three years or other appropriate certifications to allow verification that no deductions or other entries have been made that would indicate any such ownership interest.

Purchase Price Limitation. The Federal Tax Code requires that the purchase price of the residence financed with the lendable proceeds of qualified mortgage bonds may not exceed 90% of the average area purchase price applicable to such residence or 110% of the applicable average area purchase price in the case of residences located in targeted areas or residences in certain Presidentially-declared disaster areas. The Department verifies compliance with the purchase price limitations by requiring each veteran and seller of a residence to make certifications regarding the purchase price of such residence.

Income Limitation. The Federal Tax Code requires that all mortgage loans made from the lendable proceeds of qualified mortgage bonds be made only to borrowers whose family income does not exceed 115% (for mortgage loans made to families with fewer than three members, 100%) of the applicable median family income. An exception is provided for mortgage loans financed with the lendable proceeds of qualified mortgage bonds made with respect to targeted area residences and residences in certain Presidentially-declared disaster areas that permits two-thirds in aggregate amount of such mortgage loans to be made with respect to borrowers whose family income does not exceed 140% (for mortgage loans made to families with fewer than three members, 120%) of the applicable median family income and one-third in aggregate amount of such loans to be made without regard to any income limitation.

Federal tax law permits higher income limits for persons financing homes located in certain "high housing cost areas." A high housing cost area is a statistical area for which the ratios of the area's average purchase price for existing and new single family houses to the area's median income exceed 120% of the same ratios determined on a national basis. These ratios are determined separately with respect to new and existing single family residences. An area is a high housing cost area only if the ratios for both new and existing houses meet the 120% test. In high housing cost areas, the veteran income limits are increased above 115% (or 100%, as applicable) by one percent for each percentage point (1%) by which the new or existing housing price ratio, whichever is smaller, exceeds 120%. However, the new limit cannot exceed 140% (or 120%, as applicable) of the income limits otherwise applicable. Certain areas of the State may qualify as high housing cost areas.

Before a Contract of Purchase which is subject to this income limitation is financed, the Department verifies compliance with the requirements described under this caption "Loan Eligibility Requirements Imposed by the Federal Tax Code—Income Limitation" by requiring each borrower to certify the amount of family income. Family income includes income of all individuals executing both the note and mortgage and occupying the dwelling as their principal residence.

Requirements as to Assumptions. The Federal Tax Code provides that a mortgage loan financed by qualified mortgage bonds may be assumed only if each of the then applicable residence requirement, first-time homebuyer requirement, purchase price limitation, and income limitation is met with respect to such assumption. The Contracts of Purchase which are subject to this requirement will contain or do contain a "due on sale" clause, and the Department will not permit the assumption of such a Contract of Purchase unless it has determined that these requirements have been met and has obtained the appropriate certifications.

General. An issue of qualified veterans mortgage bonds or qualified mortgage bonds is treated as meeting the loan eligibility requirements of the Federal Tax Code if (i) the issuer in good faith attempted to meet all the loan eligibility requirements before the mortgage loans were executed, (ii) any failure to comply with the loan eligibility requirements is corrected within a reasonable period after such failure is first discovered, and (iii) 95% or more of the proceeds of the issue used to make mortgage loans was used to finance residences that met all such requirements at the time the mortgage loans were executed. In determining whether 95% or more of the proceeds has been so used, the Federal Tax Code permits the Department to rely on an affidavit of the veteran and, with respect to mortgage loans financed by qualified mortgage bonds, an affidavit of the seller as to the purchase price of a residence and an affidavit of the veteran and an examination of copies of the veteran's federal income tax returns for the last three years preceding the date the relevant Contract of Purchase is or was executed, even though the relevant information in such affidavits and income tax returns should ultimately prove to be untrue, unless the Department knows or has reason to believe that such information is false.

Other Requirements Imposed by the Federal Tax Code

General. Failure to comply with the applicable provisions of the Federal Tax Code may result in interest on the applicable issue of bonds being included in gross income for federal income tax purposes retroactive to the date of issuance thereof. The Federal Tax Code provides that gross income for federal income tax purposes does not include interest on a mortgage revenue bond if it is a qualified mortgage bond or a qualified veterans' mortgage bond. A qualified mortgage bond is a part of an issue of a state or political subdivision all the proceeds of which (net of amounts applied to any costs of issuance thereof and to fund a reasonably required reserve) are used to finance or to refund bonds all of the proceeds of which were used to finance owner-occupied residences and that meets certain (i) general requirements, (ii) arbitrage restrictions on the use and investment of proceeds of the issue, and (iii) loan eligibility requirements set forth in the Federal Tax Code and as more fully described above under "Loan Eligibility Requirements Imposed by the Federal Tax Code." A qualified veterans' mortgage bond is part of an issue 95 percent or more of the net proceeds of which are used to provide residences to veterans and that meets certain (i) general requirements, (ii) arbitrage restrictions on the use and investment of proceeds of the issue, and (iii) loan eligibility requirements set forth in the Federal Tax Code and as more fully described above under "Loan Eligibility Requirements Imposed by the Federal Tax Code."

The first general requirement of the Federal Tax Code which is applicable to the Offered Veterans G.O. Bonds is that the aggregate amount of qualified veterans' mortgage bonds that may be issued by the Department must not exceed the volume limit based upon statutory formula. The Offered Veterans G.O. Bonds are within the applicable limit for the Department.

An annual volume limit is also imposed on the issuance of qualified mortgage bonds. The second general requirement of the Federal Tax Code which is applicable to qualified mortgage bonds is that at least 20% of the lendable proceeds of an issue of qualified mortgage bonds which are not refunding bonds (if such set-aside was satisfied with respect to the bonds being refunded) must be made available (and applied with reasonable diligence) for owner-financing of residences in targeted areas (as defined by the Federal Tax Code) for at least one year after the date on which such funds are first available for such owner-financing (the "targeted area requirement"). The Department has covenanted to comply with such requirements to the extent required by the Federal Tax Code.

The Federal Tax Code requires the issuer of qualified mortgage bonds and qualified veterans' mortgage bonds to file with the Internal Revenue Service reports on the issuance of its qualified mortgage bonds and qualified veterans' mortgage bonds following such issuance, as well as certain mortgage loan information reports. The Department has covenanted to, file, as required, such reports with respect to the applicable bonds.

The Federal Tax Code requires that the effective interest rate on mortgage loans financed with the lendable proceeds of qualified mortgage bonds and qualified veterans' mortgage bonds may not exceed the yield on the issue by more than 1.125% (1.50% for certain prior Revenue Bonds) and that certain investment earnings on non-mortgage investments, calculated based upon the extent such investment earnings exceed the amount that would have been earned on such investments if the investments were invested at a yield equal to the yield on the issue, be rebated to the United States or to veterans. The Department has covenanted to comply with these requirements and has established procedures to determine the amount of excess earnings, if any, that must be rebated to the United States or to veterans. See APPENDIX B—"THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND—Contracts of Purchase" for discussions of provisions of the Veterans Code which affect the Department's ability to establish and to change interest rates on Contracts of Purchase.

Recapture Provision. For certain mortgage loans made after December 31, 1990 from the proceeds of qualified mortgage bonds issued after August 15, 1986, and for assumptions of such mortgage loans, the Federal Tax Code requires a payment to the United States from certain borrowers upon sale or other disposition of their homes (the "Recapture Provision"). The Recapture Provision requires that an amount determined to be the subsidy provided by a qualified mortgage bond financing to a borrower be paid to the United States on disposition of the house (but not in excess of 50% of the gain realized by the borrower). The recapture amount would (i) increase over the period of ownership, with full recapture occurring if the house were sold between four and five full years after the closing of the mortgage loan and (ii) decline ratably to zero with respect to sales occurring between five and nine full years after the closing of the mortgage loan. An exception excludes from recapture part or all of the subsidy in the case of certain assisted individuals whose incomes are less than prescribed amounts at the time of the disposition. The Federal Tax Code requires an issuer to inform borrowers of certain information with respect to the Recapture Provision. The Department has established procedures which the Department believes has enabled it to meet, and will enable it to continue to meet, such recapture information requirement.

The Federal Tax Code states that an issuer will be treated as meeting the targeted area requirement, the arbitrage restrictions on mortgage loans, the veterans provisions and the recapture information requirements if it in good faith attempted to meet all such requirements and any failure to meet such requirements was due to inadvertent error after taking all reasonable steps to comply with such requirements.

Required Redemptions. For qualified mortgage bonds issued after 1988, the Federal Tax Code permits repayments (including prepayments) of principal of mortgage loans financed with the proceeds of an issue of such bonds to be used to make additional mortgage loans for only 10 years from the date of issuance of the bonds (or the date of issuance of the original bonds in the case of refundings), after which date such amounts must be used to redeem bonds, except for a \$250,000 de minimis amount.

Compliance. The Department included provisions in the Program Documents that establish procedures, including receipt of certain affidavits from veterans, in order to assure compliance with the loan eligibility requirements and other requirements that must be satisfied subsequent to the date of issuance of the Offered Veterans G.O. Bonds. The Department has covenanted in the Resolution to do and perform all acts and things permitted by law and necessary or desirable to assure that interest paid on the Offered Veterans G.O. Bonds shall not be included in gross income for federal income tax purposes and, for such purpose, to adopt and maintain appropriate procedures.

Opinion of the Attorney General and Bond Counsel

In the opinion of the Attorney General and of Hawkins, Delafield & Wood, Bond Counsel to the State (expected to be delivered in substantially the form set forth in APPENDIX E), under existing statutes and court decisions interest on the Offered Veterans G.O. Bonds is excluded from gross income for federal income tax purposes and interest on the Offered Veterans G.O. Bonds is a specific preference item for purposes of calculating the federal individual and corporate alternative minimum taxes. In rendering such opinion, the Attorney General and Bond Counsel assume compliance by the State and the Department with and enforcement by the State and the Department of the documents authorizing the issuance of the 1997/1998 Tax Plan Bonds and the applicable Program Documents. The Attorney General and Bond Counsel express no opinion as to the exclusion from gross income of interest on any Offered Veterans G.O. Bonds subsequent to any date on which action is taken pursuant to the documents authorizing the issuance of the 1997/1998 Tax Plan Bonds for which action the documents authorizing the issuance of the 1997/1998 Tax Plan Bonds requires a legal opinion to the effect that taking such action will not adversely affect such exclusion, unless the Attorney General and such firm deliver an opinion as of such date to such effect.

Certain Additional Federal Tax Consequences

The following is a brief discussion of certain federal income tax matters with respect to the Offered Veterans G.O. Bonds under existing statutes. It does not purport to deal with all aspects of federal taxation that may be relevant to a particular owner of an Offered Veterans G.O. Bond. Prospective investors, particularly those who may be subject to special rules, are

advised to consult their own tax advisors regarding the federal tax consequences of owning and disposing of the Offered Veterans G.O. Bonds.

As noted above, interest on the Offered Veterans G.O. Bonds must be taken into account in determining the tax liability of corporations subject to the federal alternative minimum tax imposed by Section 55 of the Federal Tax Code, and interest on the Offered Veterans G.O. Bonds is a preference item in determining the tax liability of individuals, corporations, and other taxpayers subject to the alternative minimum tax imposed by Section 55 of the Federal Tax Code. Interest on the Offered Veterans G.O. Bonds must also be taken into account in determining the tax liability of foreign corporations subject to the branch profits tax imposed by Section 884 of the Federal Tax Code.

Owners of Offered Veterans G.O. Bonds should be aware that the ownership of such obligations may result in collateral federal income tax consequences to various categories of persons, such as corporations (including S corporations and certain foreign corporations), financial institutions, property and casualty insurance companies, individual recipients of Social Security or Railroad Retirement benefits, and individuals otherwise eligible for the earned income tax credit and to taxpayers deemed to have incurred or continued indebtedness to purchase or carry obligations the interest on which is not included in gross income for federal income tax purposes.

Legislation affecting municipal bonds is frequently considered by the United States Congress. For example, several bills were introduced (but not enacted) during the 104th Congress to extend the environmental tax imposed by Section 59A of the Federal Tax Code with respect to taxable years beginning before January 1, 1996. There can be no assurance that legislation enacted or proposed after the date of issuance of the Offered Veterans G.O. Bonds will not have an adverse effect on the tax-exempt status or market price of the Offered Veterans G.O. Bonds.

State Tax Matters

The Attorney General and Bond Counsel are of the opinion that the interest on the Offered Veterans G.O. Bonds is exempt from personal income taxes of the State of California under present State law.

LEGAL OPINIONS

The opinion of the Attorney General and Hawkins, Delafield & Wood, Bond Counsel to the State, approving the validity of the Offered Veterans G.O. Bonds and stating the opinions expressed under "TAX MATTERS," will be substantially in the form set forth in APPENDIX E. The Attorney General and Bond Counsel undertake no responsibility for the accuracy, completeness or fairness of this Official Statement. Certain legal matters will be passed upon by Lofton De Lancie, Disclosure Counsel to the State. Certain legal matters will be passed upon for the Underwriters by their counsel, Kutak Rock.

LITIGATION

There is not now pending or known to the Attorney General to be threatened any material litigation seeking to prevent the remarketing or sale and delivery of the Offered Veterans G.O. Bonds or questioning the validity of the Offered Veterans G.O. Bonds. As stated above, debt service on the Veterans G.O. Bonds is a continuing appropriation in the Bond Acts. See "AUTHORIZATION OF AND SECURITY FOR THE OFFERED VETERANS G.O. BONDS—Security and Payment of Veterans G.O. Bonds." In June 1998, a complaint was filed in Los Angeles County Superior Court in the case of *Howard Jarvis Taxpayers Association v. Connell* challenging the authority of the State Controller to make payments in the absence of a State budget. The lawsuit did not specifically attack the validity of the law or the continuing appropriations under the Bond Acts. The Superior Court judge, however, issued a preliminary injunction preventing the State Controller from making payments, including those made pursuant to continuing appropriations, while the State's annual budget act had not yet been enacted. As permitted by the State Constitution, the State Legislature immediately enacted and the Governor of the State signed, an emergency appropriations bill which allowed continued payment of various State obligations, including debt service. Subsequently, the State Legislature enacted and the Governor of the State signed the budget act for the 1998-99 fiscal year. See APPENDIX A—"THE STATE OF CALIFORNIA—Litigation" for more information about the status of this case.

The Attorney General and Bond Counsel have rendered an opinion that the conclusion of the Superior Court judge in the *Jarvis* case (which is now stayed pending appeal) questioning the validity of continuing appropriations, if and to the extent it would apply to the Offered Veterans G.O. Bonds, is without merit and that the California appellate course would hold that the appropriations are valid under the State Constitution and that the State Controller may make payments pursuant to such appropriations. While there can be no assurance as to the outcome of the litigation, the State believes that moneys will be available in due course on a timely basis to make all future payments of debt service on the Offered Veterans G.O. Bonds.

While at any given time, including the present, there are numerous civil actions pending against the State, which could, if determined adversely to the State, affect the State's expenditures and, in some cases, its revenues, the Attorney General is of the opinion that no pending actions are likely to have a material adverse effect on the State's ability to pay principal and purchase price of, premium, if any, and interest on the Offered Veterans G.O. Bonds when due.

See APPENDIX A—"THE STATE OF CALIFORNIA—Litigation." See APPENDIX B—"THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND—The 1943 Fund" for a discussion of certain litigation which may affect the 1943 Fund.

UNDERWRITING

The Offered Veterans G.O. Bonds are being purchased by the Underwriters listed on the front cover page. The Underwriters have jointly and severally agreed to purchase the Offered Veterans G.O. Bonds for a purchase price equal to the aggregate principal amount thereof. In connection therewith the Department will pay a fee to the Underwriters of \$552,250. The initial public offering prices of the Offered Veterans G.O. Bonds may be changed from time to time by the Underwriters.

The purchase contract relating to the Offered Veterans G.O. Bonds provides that the Underwriters will purchase all the applicable Offered Veterans G.O. Bonds if any are purchased, and that the obligation to make such purchase is subject to certain terms and conditions set forth in such purchase contract including, among others, the approval of certain legal matters by counsel.

FINANCIAL STATEMENTS

Audited General Purpose Financial Statements of the State of California (the "Financial Statements") are available for the Fiscal Year ended June 30, 1998. Such Financial Information Statements have been filed with all of the Nationally Recognized Municipal Securities Information Repositories, as part of the Official Statements for the State General Obligation Bonds sold previously during this year, and are incorporated by reference into this Official Statement. The Financial Statements are also available through electronic means. See APPENDIX A—"THE STATE OF CALIFORNIA—Financial Statements" for further information on how to obtain or view the Financial Statements.

Certain unaudited financial information for the Fiscal Year ended June 30, 1999 is included as an Exhibit to APPENDIX A. See Appendix A—"Exhibit 1—State Controller's Statement of General Fund Cash Receipts and Disbursements, July 1, 1998 - June 30, 1999 (Unaudited).

INDEPENDENT AUDITORS

Attached as Exhibit 1 to APPENDIX B are the Financial Statements for the Veterans Farm and Home Building Fund of 1943 for the years ended June 30, 1999 and 1998. These statements have been audited by Deloitte & Touche LLP, independent auditors, as indicated in their report appearing in APPENDIX B.

RATINGS

The Offered Veterans G.O. Bonds have received ratings of "Aaa" by Moody's Investors Service ("Moody's"), "AAA" by Standard & Poor's Ratings Service, a division of The McGraw-Hill Companies, Inc. ("S&P") and "AAA" by Fitch IBCA, Inc. ("Fitch"), with the understanding by such rating agencies that upon delivery of the Offered Veterans G.O. Bonds, a municipal bond insurance policy will be issued by Ambac Assurance. An explanation of the significance and status of such credit ratings may be obtained from the rating agencies furnishing the same. There is no assurance that such ratings will continue for any given period of time or that they will not be revised or withdrawn entirely by any such rating agencies, if in their respective judgments, circumstances so warrant. A revision or withdrawal of any such credit ratings could have an effect on the market price of the applicable Offered Veterans G.O. Bonds. After the Offered Veterans G.O. Bonds are rated, the State Treasurer intends to provide appropriate periodic credit information to the bond rating agencies to assist in maintaining the ratings on the Offered Veterans G.O. Bonds.

ADDITIONAL INFORMATION

The purpose of this Official Statement is to supply information to prospective buyers of the Offered Veterans G.O. Bonds. Public Resources Advisory Group has served as Financial Advisor in connection with the issuance of the Offered Veterans G.O. Bonds.

All financial and statistical data contained herein have been taken or constructed from State (including Department) records, except for information expressly attributed to other sources. The presentation of information, including tables of receipts from taxes and other revenues, is intended to show recent historic information and is not intended to indicate future or continuing trends in the financial position or other affairs of the State, including the Department. No representation is made that past experience, as it might be shown by such financial and other information, will necessarily continue or be repeated in the future. Any statements made in this Official Statement involving matters of opinion, protection or estimates, whether expressly stated or not, are set forth as such and not as representations of fact.

STATE OF CALIFORNIA

By: PHILIP ANGELIDES
Treasurer of the State of California

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APPENDIX A

THE STATE OF CALIFORNIA



*Honorable Philip Angelides
Treasurer of the State of California*

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OVERVIEW OF STATE GOVERNMENT

Organization of State Government

The State Constitution provides for three separate branches of government: the legislative, the judicial and the executive. The Constitution guarantees the electorate the right to make basic decisions, including amendments to the Constitution and local government charters. In addition, the State voters may directly influence State government through the initiative, referendum and recall processes.

California's Legislature consists of a forty-member Senate and an eighty-member Assembly. Assembly members are elected for two-year terms, and Senators are elected for four-year terms. Assembly members are limited to three terms in office and Senators to two terms. The Legislature meets almost year round for a two-year session. The Legislature employs the Legislative Analyst, who provides reports on State finances, among other subjects. The Bureau of State Audits, headed by the State Auditor, an independent office since 1993, has annually issued an auditor's report based on an examination of the General Purpose Financial Statements of the State Controller, in accordance with generally accepted accounting principles.

The Governor is the chief executive officer of the State and is elected for a four-year term. The Governor presents the annual budget and traditionally presents an annual package of bills constituting a legislative program. In addition to the Governor, State law provides for seven other statewide elected officials in the executive branch. The current elected statewide officials, their party affiliation and the dates on which they were first elected, are as follows:

<u>Office</u>	<u>Name</u>	<u>Party Affiliation</u>	<u>First Elected</u>
Governor.....	Gray Davis	Democrat	1998
Lieutenant Governor.....	Cruz Bustamante	Democrat	1998
Treasurer.....	Philip Angelides	Democrat	1998
Attorney General	Bill Lockyer	Democrat	1998
Controller	Kathleen Connell	Democrat	1994
Secretary of State.....	Bill Jones	Republican	1994
Superintendent of Public Instruction.....	Delaine Eastin	Democrat	1994
Insurance Commissioner	Chuck Quackenbush	Republican	1994

The current term for each office expires in January 2003. Persons elected to statewide offices are limited to two terms in office.

The executive branch is principally administered through thirteen major agencies and departments: Business, Transportation and Housing Agency, Child Development and Education Agency, Environmental Protection Agency, Department of Finance, Department of Food and

Agriculture, Health and Human Services Agency, Department of Industrial Relations, Resources Agency, State and Consumer Services Agency, Department of Veterans Affairs, Trade and Commerce Agency, and Youth and Adult Correctional Agency. In addition, some state programs are administered by boards and commissions, such as The Regents of the University of California, Public Utilities Commission, Franchise Tax Board and California Transportation Commission, which have authority over many functions of state government with the power to establish policy and promulgate regulations. The appointment of members of boards and commissions is usually shared by the Legislature and the Governor, and often includes ex officio members.

California has a comprehensive system of public higher education comprised of three sectors: the University of California, the California State University System and California Community Colleges. The University of California provides undergraduate, graduate and professional degrees to students. Approximately 41,000 degrees were awarded in the 1997-98 school year. About 163,000 full-time students were enrolled at the nine UC campuses and the Hastings School of Law in the fall of 1998. The California State University System, consisting of 23 campuses, provides undergraduate and graduate degrees to students. Approximately 66,000 degrees were awarded in the 1997-98 school year. About 272,000 full-time students were enrolled at the 23 campuses. The third sector consists of 106 campuses operated by 71 community college districts which provide associate degrees and certificates. Approximately 86,000 associate degrees and certificates were awarded in the 1997-98 school year. About 1.5 million students were enrolled in California's community colleges in the fall of 1998.

Employee Relations

In 1998-99, the State work force was estimated to be comprised of approximately 290,000 personnel years. Of this total, approximately 90,000 personnel years represent employees of institutions of higher education. Civil service employees who are subject to collective bargaining represent approximately 147,000 personnel years. The California State Employees' Association (CSEA), represents 9 of the 21 collective bargaining units, or approximately 52 percent of those employees subject to collective bargaining.

State law provides that state employees, defined as any civil service employee of the State and teachers under the jurisdiction of the Department of Education or the Superintendent of Public Instruction, and excluding certain other categories, have a right to form, join, and participate in the activities of employee organizations for the purpose of representation on all matters of employer-employee relations. Law enforcement employees have the right to be represented separately from other employees. The chosen employee organization has the right to represent its members, except that once an employee organization is recognized as the exclusive representative of a bargaining unit, only that organization may represent employees in that unit.

The scope of representation is limited to wages, hours, and other terms and conditions of employment. Representatives of the Governor are required to meet and confer in good faith and endeavor to reach agreement with the employee organization, and, if agreement is reached, to prepare a memorandum of understanding (MOU) and present it to the Legislature for ratification. The Governor and the recognized employee organization are authorized to agree mutually on the appointment of a mediator for the purpose of settling any disputes between the parties, or either party could request the Public Employment Relations Board to appoint a mediator.

The State has negotiated new MOUs to be effective as of July 1, 1999 with all twenty-one collective bargaining units. These MOUs have been approved by the Legislature, but still require signature by the Governor and ratification by the bargaining unit members to become final. The State has not experienced a major work stoppage in the last 23 years.

Employees' Retirement Systems

Two retirement systems, the California Public Employees' Retirement System (CalPERS) and the State Teachers' Retirement System (STRS), are administered by the State. The pension liability for all pension trust funds is determined in accordance with Governmental Accounting Standards Board (GASB) Statement No. 27, Accounting for Pensions by State and Local Government Employers. CalPERS' and STRS' investments are reported at fair value, generally determined based on published market prices, quotations from major investment firms, and other factors for assets without a published market price.

CalPERS administers four defined benefit retirement plans: the Public Employees' Retirement System (PERS), the Judges' Retirement System, the Judges' Retirement System II, and the Legislators' Retirement System. CalPERS issues a publicly available financial report that includes financial statements and ten years of required supplementary information for these four plans. This report may be obtained by writing to the California Public Employees' Retirement System, Central Supply, P.O. Box 942715, Sacramento, California 94229-2715. (This disclosure statement will only discuss the PERS, which is by far the largest of the four programs).

CalPERS uses the accrual basis of accounting. Member contributions are recorded when due. Employer contributions are recorded when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due in accordance with the terms of each plan.

All State, classified school and participating local agency employees who work on a half time or more basis are eligible to participate in PERS. Benefits are based on members' years of service, age, final compensation, and benefit formula as calculated under the applicable plans. Vesting occurs after five or ten years depending on the plan. All plans provide death, disability, and survivor benefits. The benefits provisions under each plan are established by statute.

Under the State Constitution, CalPERS has the authority to invest in stocks, bonds, mortgages, real estate, and other prudent investments. CalPERS also holds investments in

futures and options and enters into forward foreign currency exchange contracts. As of June 30, 1998, futures and options of approximately \$76 million were held for investment purposes and CalPERS had approximately \$76 million net exposure to loss from forward foreign currency exchange transactions related to the \$30 billion international debt and equity portfolios. CalPERS' had assets with a fair market value of \$157.5 billion as of April 30, 1999, an increase of \$8.7 billion from February 28, 1999.

The PERS is administered by the Board of Administration of CalPERS, and is a multiple-employer defined benefit retirement system. As of June 30, 1998, employers participating in PERS include the State, 1,071 school districts, 1,304 public agencies and certain special purpose authorities, which are legally separate from the State. At June 30, 1998, PERS had approximately 331,622 retirees, survivors and beneficiaries receiving a monthly allowance and 776,333 active and inactive members.

Benefits are funded by contributions from members and the employers and earnings from investments. Member and employer contributions are a percentage of the applicable member's compensation. The contribution from members is defined by law and based on the applicable benefit formula. The employer contribution rates are determined by periodic actuarial valuations. State contributions are paid quarterly and other employer contributions are paid monthly.

The excess of the actuarial value of assets over the actuarial accrued liability of the PERS relating to State employees was \$1.3 billion as of June 1, 1997. This is a result of the difference between the actuarial value of assets of \$44.8 billion and the actuarial accrued liability of \$43.5 billion. The PERS had assets with a total actuarial value of \$108.5 billion as of June 30, 1997.

STRS administers the California State Teachers' Retirement Plan (Plan), which is comprised of two distinct benefit structures: a Defined Benefit (DB) Program as set forth in Part 13 of the California Education Code and a Cash Balance (CB) Benefit Program as set forth in Part 14 of the California Education Code. Together, Parts 13 and 14 are referred to as the "Teachers' Retirement Law." Prior to January 1, 1999, STRS maintained separate trust funds for the assets of the DB Plan and the CB Plan. Administrative expenses for each plan were separately budgeted to and paid from each plan's trust fund. State Law merged the Cash Balance Fund with the Teachers' Retirement Fund as of January 1, 1999. The resulting single trust fund finances the two distinct benefit structures identified above. The two benefit structures together comprise a single plan that is known as the "State Teachers' Retirement Plan." STRS also offers through a third party administrator a defined contribution plan that meets the requirements of the Internal Revenue Code Section 403(b) and is open to any employee who is eligible to participate. STRS issues a publicly available financial report that includes financial statements and required supplementary information on the plans. This report may be obtained from the State Teachers' Retirement System, Audits Division, 7667 Folsom Boulevard, 2nd Floor, Sacramento, California 95826.

STRS uses the accrual basis of accounting. Member contributions are recognized in the period in which the contributions are due. Employer and State contributions are recognized when due and the employer or the State has made a formal commitment to provide the contributions. Benefits are recognized when due and payable in accordance with the retirement

program. STRS' investments consist of government, corporate, and international bonds, domestic and international equities, mutual funds, limited partnership holdings, real estate, mortgages, and other investments. At July 31, 1999, STRS had reported assets of \$99.136 billion, an increase of \$2.87 billion from May 31, 1999.

STRS administers the TRF, a cost sharing multiple-employer defined benefit retirement plan that provides pension benefits to teachers and certain other employees of the California public school system. Membership in the TRF is mandatory for all employees meeting the eligibility requirements. The State Teachers' Retirement Law establishes the benefits for the TRF. At June 30, 1998, the TRF had approximately 1,157 contributing members, approximately 385,530 plan members, and 157,747 benefit recipients. The State is a nonemployer contributor to the TRF.

Benefits are funded under the TRF by contributions from members, employers, the State, and earnings from investments. Member and employer contributions are a percentage of applicable member earnings. The State Teachers' Retirement Law governs member rates (8% of the applicable member's earnings), employer contribution rates (8.25% of the applicable member's earnings), and the State's contributions. The State's statutory contribution to the system is 4.3% of the previous calendar year's member payroll. Subsequent to achieving a fully funded system, the State will contribute only the amount necessary to fund the normal cost of the current benefit program unless a subsequent unfunded obligation occurs.

STRS administers the CBPlan as a separate defined benefit plan designed for the employees of California public schools who are hired to perform creditable service for less than 50% of the full time equivalent for the position. At June 30, 1998, the CBPlan had 13 contributing school districts, approximately 3,507 contributing members and assets of \$2 million. For reporting purposes, the CBPlan is combined with the TRF.

For the year ended June 30, 1997, the unfunded actuarial accrued liability for the TRF, including the CBPlan, was \$1.9 billion and the actuarial value of assets was \$67.980 billion.

Year 2000-Related Information Technology

The State's reliance on information technology in every aspect of its operations has made Year 2000-related ("Y2K") information technology ("IT") issues a high priority for the State. The Department of Information Technology ("DOIT"), an independent office reporting directly to the Governor, is responsible for ensuring the State's information technology processes are fully functional before the year 2000. The DOIT has created a Year 2000 Task Force and a California 2000 Office to establish statewide policy requirements; to gather, coordinate, and share information; and to monitor statewide progress. In December 1996, the DOIT began requiring departments to report on Y2K activities and currently requires departments to report each week on their Y2K status. The DOIT has emphasized to departments that efforts should be focused on applications that support mission-critical services or functions.

The risks posed by Y2K information technology related issues are not confined to computer systems, but also include problems presented by embedded microchips (products or

systems that contain microchips to perform functions such as traffic control, instruments used in hospitals or medical laboratories, and California Aqueduct monitoring). To address these problems, Governor Davis issued Executive Order D-3-99, broadening the responsibilities of the DOIT to resolve these issues as well as legal questions associated with Y2K issues.

In its quarterly report for the period ending October 15, 1999 (the "October Quarterly Report"), the DOIT discusses the State's progress in addressing Y2K issues. Since the DOIT's previous Quarterly Report in July, the DOIT continued to receive and review departmental reports and assessments. The DOIT also arranged for outside vendors to perform an Independent Verification and Validation of state mission critical system documentation. As remediation of mission critical systems nears completion, the DOIT is also focusing on assuring that each entity has in place a Continuity Plan for Business ("CPB") to assure delivery of critical services in the event of Y2K problems. All state departments with mission critical systems have filed CPB plans with the DOIT.

An ongoing survey of State departments reported in the October Quarterly Report indicated that for some 500 mission critical IT systems and interfaces, approximately 97% had completed remediation. (Designation of a system as "mission critical" is made by the department, and the total number changes from time to time as departments re-evaluate their activities.)

The DOIT estimates total Y2K costs identified by the departments under its supervision at about \$357 million. These costs are part of much larger overall IT costs incurred annually by the State, including costs incurred by certain independent State entities, such as the judiciary, the Legislature, the University of California and California State University System. Furthermore, cost estimates for embedded systems only apply to the subset of embedded systems posing the highest risk to essential programs. For fiscal year 1999-00, the Legislature created a fund of \$33.5 million (\$13.5 million General Fund) for unanticipated Y2K costs, which can be increased if necessary.

The State Treasurer's Office has reported that its systems for bond payments are fully Y2K compliant. The State Controller's Office has reported that it has completed the necessary Y2K remediation projects for the State fiscal and accounting system, consistent with the Governor's Executive Order. Both offices are actively working with the outside entities with whom they interface to ensure that they are also compliant.

In sum, although substantial progress has been made toward the goal of Y2K compliance, the task is very large and will likely encounter some unexpected difficulties. The State cannot guarantee that all mission critical systems will be ready and tested by late 1999 or what impact the failure of any particular IT system(s) or the outside interfaces that exchange information with IT systems might have. However, the DOIT is requiring that all mission critical systems have a continuity business plan in place to mitigate potential system failures.

STATE INDEBTEDNESS

General

The State Treasurer is responsible for the sale of debt obligations of the State and its various authorities and agencies. The State has always paid the principal of and interest on its general obligation bonds, general obligation commercial paper, lease-purchase debt and short-term obligations, including revenue anticipation notes and revenue anticipation warrants, when due.

Capital Facilities Financing

General Obligation Bonds - The State Constitution prohibits the creation of general obligation indebtedness of the State unless a bond law is approved by a majority of the electorate voting at a general election or a direct primary. General obligation bond acts provide that debt service on general obligation bonds shall be appropriated annually from the General Fund and all debt service on general obligation bonds is paid from the General Fund. Under the State Constitution, debt service on general obligation bonds is the second charge to the General Fund after the application of moneys in the General Fund to the support of the public school system and public institutions of higher education. Certain general obligation bond programs receive revenues from sources other than the sale of bonds or the investment of bond proceeds.

As of October 1, 1999, the State had outstanding \$19,630,276,000 aggregate principal amount of long-term general obligation bonds, and unused voter authorizations for the future issuance of \$12,827,414,000 of long-term general obligation bonds. This latter figure consists of \$4,451,734,000 of authorized commercial paper notes, described below (of which \$814,565,000 was outstanding), which had not yet been refunded by general obligation bonds, and \$8,375,680,000 of other authorized but unissued general obligation debt. See the table "Authorized and Outstanding General Obligation Bonds" under "State Debt Tables" following page A-46.

In its 1999 session, the Legislature passed and the Governor signed five bond acts, totaling \$4.69 billion in new authorizations. These bond acts will be placed on the March 7, 2000 ballot for voter approval.

Commercial Paper Program - Pursuant to legislation enacted in 1995, voter approved general obligation indebtedness may be issued either as long-term bonds, or, for some but not all bond acts, as commercial paper notes. Commercial paper notes may be renewed or may be refunded by the issuance of long-term bonds. The State issues long-term general obligation bonds from time to time to retire its general obligation commercial paper notes. Pursuant to the terms of the bank credit agreement presently in effect supporting the general obligation commercial paper program, not more than \$1.5 billion of general obligation commercial paper notes may be outstanding at any time; this amount may be increased or decreased in the future. Commercial paper notes are deemed issued upon authorization by the respective Finance Committees, whether or not such notes are actually issued. As of October 1, 1999 the Finance Committees had authorized the issuance of up to \$4,451,734,000 of commercial paper notes; as of that date

\$814,565,000 aggregate principal amount of general obligation commercial paper notes was outstanding.

Lease-Purchase Debt - In addition to general obligation bonds, the State builds and acquires capital facilities through the use of lease-purchase borrowing. Under these arrangements, the State Public Works Board, another State or local agency or a joint powers authority issues bonds to pay for the construction of facilities such as office buildings, university buildings or correctional institutions. These facilities are leased to a State agency or the University of California under a long-term lease which provides the source of payment of the debt service on the lease-purchase bonds. In some cases, there is not a separate bond issue, but a trustee directly creates certificates of participation in the State's lease obligation, which are marketed to investors. Under applicable court decisions, such lease arrangements do not constitute the creation of "indebtedness" within the meaning of the Constitutional provisions which require voter approval. For purposes of this section of the Official Statement and the tables following, "lease-purchase debt" or "lease-purchase financing" means principally bonds or certificates of participation for capital facilities where the rental payments providing the security are a direct or indirect charge against the General Fund and also includes revenue bonds for a State energy efficiency program secured by payments made by various State agencies under energy service contracts. Certain of the lease-purchase financings are supported by special funds rather than the General Fund (see "State Finances--Sources of Tax Revenue"). The table does not include equipment leases or leases which were not sold, directly or indirectly, to the public capital market. The State had \$6,578,874,434 General Fund-supported lease-purchase debt outstanding at October 1, 1999. The State Public Works Board, which is authorized to sell lease revenue bonds, had \$2,035,434,000 authorized and unissued as of October 1, 1999. Also, as of that date certain joint powers authorities were authorized to issue approximately \$69,500,000 of revenue bonds to be secured by State leases.

Non-Recourse Debt - Certain State agencies and authorities issue revenue obligations for which the General Fund has no liability. Revenue bonds represent obligations payable from State revenue-producing enterprises and projects, which are not payable from the General Fund, and conduit obligations payable only from revenues paid by private users of facilities financed by the revenue bonds. The enterprises and projects include transportation projects, various public works projects, public and private educational facilities (including the California State University and University of California systems), housing, health facilities and pollution control facilities. There are 17 agencies and authorities authorized to issue revenue obligations (excluding lease-purchase debt). State agencies and authorities had \$26,008,006,628 aggregate principal amount of revenue bonds and notes which are non-recourse to the General Fund outstanding as of June 30, 1999, as further described in the table "State Agency Revenue Bonds and Conduit Financing" under "State Debt Tables" following page A-46.

Detailed tables showing the State's long-term debt appear after page A-46.

Cash Flow Borrowings

As part of its cash management program, the State has regularly issued short-term obligations to meet cash flow needs. The following table shows the amount of revenue

anticipation notes (“Notes”) and revenue anticipation warrants (“Warrants”) issued over the past five fiscal years. See “State Finances--State Warrants,” “Prior Fiscal Years’ Financial Results” and “Current State Budget” below.

The State issued \$1.0 billion of revenue anticipation notes for the 1999-2000 Fiscal Year to mature on June 30, 2000.

State of California
Revenue Anticipation Notes and Warrants Issued
Fiscal Years 1994-95 to 1999-2000

<u>Fiscal Year</u>	<u>Type</u>	<u>Principal Amount (Billions)</u>	<u>Date of Issue</u>	<u>Maturity Date</u>
1994-1995	Warrants Series C-D	\$4.0	July 26, 1994	April 25, 1996
	Notes Series A-C	3.0	August 3, 1994	June 28, 1995
1995-1996	Notes	2.0	April 25, 1996	June 28, 1996
1996-1997	Notes Series A-C	3.0	August 6, 1996	June 30, 1997
1997-1998	Notes	3.0	September 9, 1997	June 30, 1998
1998-1999	Notes	1.7	October 1, 1998	June 30, 1999
1999-2000	Notes Series A-B	1.0	October 1, 1999	June 30, 2000

SOURCE: State of California, Office of the Treasurer.

STATE FINANCES

The Budget Process

The State's fiscal year begins on July 1 and ends on June 30. The State operates on a budget basis, using a modified accrual system of accounting, with revenues credited in the period in which they are measurable and available and expenditures debited in the period in which the corresponding liabilities are incurred.

The annual budget is proposed by the Governor by January 10 of each year for the next fiscal year (the "Governor's Budget"). Under state law, the annual proposed Governor's Budget cannot provide for projected expenditures in excess of projected revenues and balances available from prior fiscal years. Following the submission of the Governor's Budget, the Legislature takes up the proposal.

Under the State Constitution, money may be drawn from the Treasury only through an appropriation made by law. The primary source of the annual expenditure authorizations is the Budget Act as approved by the Legislature and signed by the Governor. The Budget Act must be approved by a two-thirds majority vote of each House of the Legislature. The Governor may reduce or eliminate specific line items in the Budget Act or any other appropriations bill without vetoing the entire bill. Such individual line-item vetoes are subject to override by a two-thirds majority vote of each House of the Legislature.

Appropriations also may be included in legislation other than the Budget Act. Bills containing appropriations (except for K-14 education) must be approved by a two-thirds majority vote in each House of the Legislature and be signed by the Governor. Bills containing K-14 education appropriations only require a simple majority vote. Continuing appropriations, available without regard to fiscal year, may also be provided by statute or the State Constitution. There is litigation pending concerning the validity of such continuing appropriations. See "Litigation" below.

Funds necessary to meet an appropriation need not be in the State Treasury at the time such appropriation is enacted; revenues may be appropriated in anticipation of their receipt.

The General Fund

The moneys of the State are segregated into the General Fund and over 900 special funds, including bond, trust and pension funds. The General Fund consists of revenues received by the State Treasury and not required by law to be credited to any other fund, as well as earnings from the investment of state moneys not allocable to another fund. The General Fund is the principal operating fund for the majority of governmental activities and is the depository of most of the major revenue sources of the State. For additional financial data relating to the General Fund, see Exhibit 1 to this Appendix A. The General Fund may be expended as a consequence of

appropriation measures enacted by the Legislature and approved by the Governor, as well as appropriations pursuant to various constitutional authorizations and initiative statutes.

The Special Fund for Economic Uncertainties

The Special Fund for Economic Uncertainties ("SFEU") is funded with General Fund revenues and was established to protect the State from unforeseen revenue reductions and/or unanticipated expenditure increases. Amounts in the SFEU may be transferred by the State Controller as necessary to meet cash needs of the General Fund. The State Controller is required to return moneys so transferred without payment of interest as soon as there are sufficient moneys in the General Fund.

The legislation creating the SFEU (Government Code §16418) contains a continuous appropriation from the General Fund authorizing the State Controller to transfer to the SFEU, as of the end of each fiscal year, the lesser of (i) the unencumbered balance in the General Fund and (ii) the difference between the State's "appropriations subject to limitation" for the fiscal year then ended and its "appropriations limit" as defined in Section 8 of Article XIII B of the State Constitution and established in the Budget Act for that fiscal year, as jointly estimated by the State's Legislative Analyst's Office and the Department of Finance. For a further description of Article XIII B, see "State Appropriations Limit" below. In certain circumstances, moneys in the SFEU may be used in connection with disaster relief.

For budgeting and accounting purposes, any appropriation made from the SFEU is deemed an appropriation from the General Fund. For year-end reporting purposes, the State Controller is required to add the balance in the SFEU to the balance in the General Fund so as to show the total moneys then available for General Fund purposes.

The June 30, 1999, SFEU projection reflects the latest revenue projections and expenditure amounts as updated in the 1999 Budget Act. As in any year, the Budget Act and related trailer bills are not the only pieces of legislation which appropriate funds. Other factors including re-estimates of revenues and expenditures, existing statutory requirements, and additional legislation introduced and passed by the Legislature may impact the reserve amount.

At the time of signing of the 1999 Budget Act, on June 29, 1999, the Department of Finance projected the SFEU would have a balance of about \$1.932 billion at June 30, 1999, compared to the original budgeted amount of \$1.1 billion. The 1999 Budget Act projects a balance in the SFEU of \$880 million at June 30, 2000. See "Current State Budget" below.

Inter-Fund Borrowings

Inter-fund borrowing has been used for many years to meet temporary imbalances of receipts and disbursements in the General Fund. As of June 30, 1999, the General Fund had no outstanding loans from the SFEU, General Fund special accounts or other special funds.

In the event the General Fund is or will be exhausted, the State Controller is required to notify the Governor and the Pooled Money Investment Board (the "PMIB," consisting of the State Director of Finance, the State Treasurer and the State Controller). The Governor may then order the State Controller to direct the transfer of all or any part of the moneys not needed in special funds to the General Fund from such special funds, as determined by the PMIB. All money so transferred must be returned to the special fund from which it was transferred as soon as there is sufficient money in the General Fund to do so. Transfers cannot be made from a special fund which will interfere with the objective for which such special fund was created, or from certain specific funds. When moneys transferred to the General Fund in any fiscal year from any special fund pursuant to the inter-fund borrowing mechanism exceed ten percent of the total additions as shown in the statement of operations of the preceding fiscal year as set forth in the Budgetary (Legal Basis) annual report of the State Controller, interest must be paid on such excess at a rate determined by the PMIB to be the current earning rate of the Pooled Money Investment Account.

Although any determination of whether a proposed borrowing from one of the special funds is permissible, any such determination must be made with regard to the facts and circumstances existing at the time of the proposed borrowing. The Attorney General of the State has identified certain criteria relevant to such a determination. For instance, amounts in the special funds eligible for inter-fund borrowings are legally available to be transferred to the General Fund if a reasonable estimate of expected General Fund revenues, based upon legislation already enacted, indicates that such transfers can be paid from the General Fund promptly if needed by the special funds or within a short period of time if not needed. In determining whether this requirement has been met, the Attorney General has stated that consideration may be given to the fact that General Fund revenues are projected to exceed expenditures entitled to a higher priority than payment of internal transfers, i.e., expenditures for the support of the public school system and public institutions of higher education and the payment of debt service on general obligation bonds of the State.

At the November 1998 election voters approved Proposition 2. This proposition requires the General Fund to repay loans made from certain transportation special accounts (such as the State Highway Account) at least once per fiscal year, or up to 30 days after adoption of the annual budget act. Since the General Fund may reborrow from the transportation accounts soon after the annual repayment is made, the proposition is not expected to have any adverse impact on the State's cash flow.

The following chart shows General Fund internal borrowable resources on June 30 of each of the Fiscal Years 1995-96 through 1998-99 and estimates for 1999-2000:

General Fund Internal Borrowable Resources
(Cash Basis)
(Millions)

	June 30				
	1996	1997	1998	1999	2000
Available Internal Borrowable Resources	\$5,211.0	\$6,242.2	\$6,866.8	\$8,720.0	\$7,788.1
Outstanding Loans					
From Special Fund for Economic Uncertainties	20.3	281.2	-0-	-0-	880.0
From Special Funds and Accounts	<u>1,433.7</u>	<u>909.2</u>	<u>-0-</u>	<u>-0-</u>	<u>447.6</u>
Total Outstanding Internal Loans	<u>1,454.0</u>	<u>1,190.4</u>	<u>-0-</u>	<u>-0-</u>	<u>1,327.6</u>
Unused Internal Borrowable Resources	<u>\$3,757.0</u>	<u>\$5,051.8</u>	<u>\$6,866.8</u>	<u>\$8,720.0</u>	<u>\$6,460.5</u>

SOURCE: State of California, Office of the State Controller and State of California, Department of Finance. Information for the Fiscal Years ended June 30, 1996 through 1999 are actual figures. For the year ending June 30, 2000, these figures were estimated as of August 18, 1999, by the Department of Finance (except for Available Internal Borrowable Resources, estimated by the State Controller).

Investment of Funds

Moneys on deposit in the State's Centralized Treasury System are invested by the Treasurer in the Pooled Money Investment Account (the "PMIA"). As of September 30, 1999, the PMIA held approximately \$22.02 billion of State moneys, and \$12.73 billion of moneys invested for about 2,747 local governmental entities through the Local Agency Investment Fund ("LAIF"). The assets of the PMIA as of September 30, 1999, are shown in the following table:

Analysis of the Pooled Money Investment Account Portfolio*

<u>Type of Security</u>	<u>Amount (Millions)</u>	<u>Percent Of Total</u>
U.S. Treasury Bills and Notes	\$5,352	15.4
Commercial Paper (corporate)	8,397	24.2
Certificates of Deposits	6,489	18.7
Corporate Bonds	2,291	6.6
Federal Agency Securities	7,081	20.4
Bankers Acceptances	0	0
Bank Notes	1,958	5.6
Loans Per Government Code	2,332	6.7
Time Deposits	2,474	7.1
Repurchases	0	0
Reverse Repurchases	<u>(1,632)</u>	<u>(4.7)</u>
	<u>\$34,742</u>	<u>100%</u>

*Totals may not add due to rounding.

SOURCE: State of California, Office of the Treasurer.

The State's treasury operations are managed in compliance with the California Government Code and according to a statement of investment policy which sets forth permitted investment vehicles, liquidity parameters and maximum maturity of investments. The PMIA operates with the oversight of the PMIB (consisting of the State Treasurer, the State Controller and the Director of Finance). The LAIF portion of the PMIA operates with the oversight of the Local Agency Investment Advisory Board (consisting of the State Treasurer and four other appointed members).

The Treasurer does not invest in leveraged products or inverse floating rate securities. The investment policy permits the use of reverse repurchase agreements subject to limits of no more than 10 percent of the PMIA. All reverse repurchase agreements are cash matched either to the maturity of the reinvestment or an adequately positive cash flow date which is approximate to the maturity of the reinvestment.

The average life of the investment portfolio of the PMIA as of September 30, 1999 was 193 days.

State Warrants

No money may be drawn from the State Treasury except upon a warrant duly issued by the State Controller. The State Controller is obligated to draw every warrant on the fund out of which it is payable for the payment of money directed by State law to be paid out of the State Treasury; however, a warrant may not be drawn unless authorized by law and unless unexhausted

specific appropriations provided by law are available to meet it. State law provides two methods for the State Controller to respond if the General Fund has insufficient "Unapplied Money" available to pay a warrant when it is drawn, referred to generally as "registered warrants" and "reimbursement warrants." "Unapplied Money" consists of money in the General Fund for which outstanding warrants have not already been drawn and which would remain in the General Fund if all outstanding warrants previously drawn and then due were paid. Unapplied Money may include moneys transferred to the General Fund from the SFEU and internal borrowings from the special funds (to the extent permitted by law).

If a warrant is drawn on the General Fund for an amount in excess of the amount of Unapplied Money in the General Fund, after deducting from such Unapplied Money the amount, as estimated by the State Controller, required by law to be set apart for obligations having priority over obligations to which such warrant is applicable, the warrant must be registered by the State Treasurer on the reverse side as not paid because of the shortage of funds in the General Fund. The State Controller then delivers such a "registered warrant" to persons or entities (e.g., employees, suppliers and local governments) otherwise entitled to receive payments from the State. A registered warrant bears interest at a rate designated by the PMIB up to a maximum of 5 percent per annum. Registered warrants have no fixed maturity date, but are redeemed when the Controller, with the approval of the PMIB, determines there would be sufficient Unapplied Money in the General Fund. The State Controller notifies the State Treasurer, who publishes a notice that the warrants in question are payable.

In lieu of issuing individual registered warrants to numerous creditors, there is an alternative procedure whereby the Governor, upon request of the State Controller, may create a General Cash Revolving Fund in the State Treasury which may borrow from other State special funds to meet payments authorized by law. The State Controller may then issue "reimbursement warrants" at competitive bid to reimburse the General Cash Revolving Fund, thereby increasing cash resources for the General Fund to cover required payments. The General Cash Revolving Fund is created solely to facilitate the issuance of registered reimbursement warrants. Reimbursement warrants have a fixed maturity date, and must be paid by the State Treasurer on their maturity date from any Unapplied Money in the General Fund and available therefor.

See "State Indebtedness--Cash Flow Borrowings" above for a discussion of warrants issued by the State in recent years to meet the State's cash needs.

Welfare Reform

Congress passed and the President signed (on August 22, 1996) the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (P.L. 104-193, the "Law") fundamentally reforming the nation's welfare system. Among its many provisions, the Law includes: (i) conversion of Aid to Families with Dependent Children from an entitlement program to a block grant titled Temporary Assistance for Needy Families (TANF), with lifetime time limits on TANF recipients, work requirements and other changes; (ii) provisions denying certain federal welfare and public benefits to legal noncitizens (this provision has been amended by subsequent federal law), allowing states to elect to deny additional benefits (including TANF)

to legal noncitizens, and generally denying almost all benefits to illegal immigrants; and (iii) changes in the Food Stamp program, including reducing maximum benefits and imposing work requirements.

California's response to the federal welfare reforms is embodied in Chapter 270, Statutes of 1997. This new basic state welfare program is called California Work Opportunity and Responsibility to Kids ("CalWORKs"), which replaced the former Aid to Families with Dependent Children (AFDC) and Greater Avenues to Independence (GAIN) programs, effective January 1, 1998. Consistent with the federal law, CalWORKs contains new time limits on receipt of welfare aid, both lifetime as well as for any current period on aid. The centerpiece of CalWORKs is the linkage of eligibility to work participation requirements. Administration of the new CalWORKs program is largely at the county level, and counties are given financial incentives for success in this program.

The long-term impact of the new federal Law and CalWORKs cannot be determined until there has been more experience and until an independent evaluation of the CalWORKs program is completed. In the short-term, the implementation of the CalWORKs program has continued the trend of declining welfare caseloads. The CalWORKs caseload trend is projected to be 646,000 in 1998-99 and 602,000 in 1999-00, down from a high of 921,000 cases in 1994-95.

The 1999 Budget Act proposes expenditures which will continue to meet, but not exceed, the federally-required \$2.9 billion combined State and county maintenance-of-effort (MOE) requirement. Total CalWORKs-related expenditures are estimated to be \$7.3 billion for 1998-99 and \$7.3 billion for 1999-00, including child care transfer amounts for the Department of Education.

Local Governments

The primary units of local government in California are the counties, ranging in population from 1,200 in Alpine County to over 9,600,000 in Los Angeles County. Counties are responsible for the provision of many basic services, including indigent health care, welfare, jails and public safety in unincorporated areas. There are also about 470 incorporated cities, and thousands of special districts formed for education, utility and other services. The fiscal condition of local governments has been constrained since the enactment of "Proposition 13" in 1978, which reduced and limited the future growth of property taxes and limited the ability of local governments to impose "special taxes" (those devoted to a specific purpose) without two-thirds voter approval. Counties, in particular, have had fewer options to raise revenues than many other local government entities, and have been required to maintain many services.

In the aftermath of Proposition 13, the State provided aid to local governments from the General Fund to make up some of the loss of property tax moneys, including taking over the principal responsibility for funding K-12 schools and community colleges. During the recession, the Legislature eliminated most of the remaining components of post-Proposition 13 aid to local government entities other than K-14 education districts by requiring cities and counties to transfer some of their property tax revenues to school districts. However, the Legislature also

provided additional funding sources (such as sales taxes) and reduced certain mandates for local services. Since then the State has also provided additional funding to counties and cities through such programs as health and welfare realignment, welfare reform, trial court restructuring, the COPs program supporting local public safety departments, and various other measures.

The 1999 Budget Act includes a \$150 million one-time subvention from the General Fund to local agencies for relief from the 1992 and 1993 property tax shifts. Legislation has been passed, subject to voter approval at the election in November, 2000, to provide a more permanent payment to local governments to offset the property tax shift. In addition, legislation was enacted in 1999 to provide annually up to \$50 million relief to cities based on 1997-98 costs of jail booking and processing fees paid to counties.

Historically, funding for the State's trial court system was divided between the State and the counties. However, Chapter 850, Statutes of 1997, implemented a restructuring of the State's trial court funding system. Funding for the courts, with the exception of costs for facilities, local judicial benefits, and revenue collection, was consolidated at the State level. The county contribution for both their general fund and fine and penalty amounts is capped at the 1994-95 level and becomes part of the Trial Court Trust Fund, which supports all trial court operations. The State assumed responsibility for future growth in trial court funding. The consolidation of funding is intended to streamline the operation of the courts, provide a dedicated revenue source, and relieve fiscal pressure on the counties. Beginning in 1998-99, the county general fund contribution for court operations is reduced by \$300 million, and cities will retain \$62 million in fine and penalty revenue previously remitted to the State. The General Fund reimbursed the \$362 million revenue loss to the Trial Court Trust Fund. The 1999 Budget Act includes funds to further reduce the county general fund contribution by an additional \$96 million by reducing by 100 percent the contributions of the next 18 smallest counties and by 10 percent the general fund contribution of the remaining 21 counties.

The entire statewide welfare system has been changed in response to the change in federal welfare law enacted in 1996 (see "Welfare Reform" above). Under the CalWORKs program, counties are given flexibility to develop their own plans, consistent with state law, to implement the program and to administer many of its elements, and their costs for administrative and supportive services are capped at the 1996-97 levels. Counties are also given financial incentives if, at the individual county level or statewide, the CalWORKs program produces savings associated with specified standards. Counties will still be required to provide "general assistance" aid to certain persons who cannot obtain welfare from other programs.

In 1996, voters approved Proposition 218, entitled the "Right to Vote on Taxes Act," which incorporates new Articles XIII C and XIII D into the California Constitution. These new provisions place limitations on the ability of local government agencies to impose or raise various taxes, fees, charges and assessments without voter approval. Certain "general taxes" imposed after January 1, 1995, must be approved by voters in order to remain in effect. In addition, Article XIII C clarifies the right of local voters to reduce taxes, fees, assessments or charges through local initiatives. There are a number of ambiguities concerning the Proposition and its impact on local governments and their bonded debt which will require interpretation by

the courts or the Legislature. Proposition 218 does not affect the State or its ability to levy or collect taxes.

State Appropriations Limit

The State is subject to an annual appropriations limit imposed by Article XIII B of the State Constitution (the "Appropriations Limit"). The Appropriations Limit does not restrict appropriations to pay debt service on voter-authorized bonds.

Article XIII B prohibits the State from spending "appropriations subject to limitation" in excess of the Appropriations Limit. "Appropriations subject to limitation," with respect to the State, are authorizations to spend "proceeds of taxes," which consist of tax revenues, and certain other funds, including proceeds from regulatory licenses, user charges or other fees to the extent that such proceeds exceed "the cost reasonably borne by that entity in providing the regulation, product or service," but "proceeds of taxes" exclude most state subventions to local governments, tax refunds and some benefit payments such as unemployment insurance. No limit is imposed on appropriations of funds which are not "proceeds of taxes," such as reasonable user charges or fees and certain other non-tax funds.

Not included in the Appropriations Limit are appropriations for the debt service costs of bonds existing or authorized by January 1, 1979, or subsequently authorized by the voters, appropriations required to comply with mandates of courts or the federal government, appropriations for qualified capital outlay projects, appropriations of revenues derived from any increase in gasoline taxes and motor vehicle weight fees above January 1, 1990 levels, and appropriation of certain special taxes imposed by initiative (e.g., cigarette and tobacco taxes). The Appropriations Limit may also be exceeded in cases of emergency.

The State's Appropriations Limit in each year is based on the limit for the prior year, adjusted annually for changes in state per capita personal income and changes in population, and adjusted, when applicable, for any transfer of financial responsibility of providing services to or from another unit of government or any transfer of the financial source for the provisions of services from tax proceeds to non tax proceeds. The measurement of change in population is a blended average of statewide overall population growth, and change in attendance at local school and community college ("K-14") districts. The Appropriations Limit is tested over consecutive two-year periods. Any excess of the aggregate "proceeds of taxes" received over such two-year period above the combined Appropriations Limits for those two years is divided equally between transfers to K-14 districts and refunds to taxpayers.

The Legislature has enacted legislation to implement Article XIII B which defines certain terms used in Article XIII B and sets forth the methods for determining the Appropriations Limit. California Government Code Section 7912 requires an estimate of the Appropriations Limit to be included in the Governor's Budget, and thereafter to be subject to the budget process and established in the Budget Act.

The following table shows the State's Appropriations Limit for the past four fiscal years and the current fiscal year. As of the enactment of the 1999-2000 Budget, the Department of Finance projects the State's Appropriations Subject to Limitations will be \$6.1 billion under the State's Appropriations Limit in Fiscal Year 1999-00.

**State Appropriations Limit
(Millions)**

	Fiscal Years				
	<u>1995-96</u>	<u>1996-97</u>	<u>1997-98</u>	<u>1998-99*</u>	<u>1999-00*</u>
State Appropriations Limit	\$39,309	\$42,002	\$44,778	\$47,573	\$50,673
Appropriations Subject to Limit	<u>(34,186)</u>	<u>(35,103)</u>	<u>(40,743)</u>	<u>(42,674)</u>	<u>(44,528)</u>
Amount (Over)/Under Limit	<u>\$5,123</u>	<u>\$6,899</u>	<u>\$4,035</u>	<u>\$4,899</u>	<u>\$6,145</u>

*Estimated/Projected

SOURCE: State of California, Department of Finance.

Proposition 98

On November 8, 1988, voters of the State approved Proposition 98, a combined initiative constitutional amendment and statute called the "Classroom Instructional Improvement and Accountability Act." Proposition 98 changed State funding of public education below the university level and the operation of the State Appropriations Limit, primarily by guaranteeing K-14 schools a minimum share of General Fund revenues. Under Proposition 98 (as modified by Proposition 111, which was enacted on June 5, 1990), K-14 schools are guaranteed the greater of (a) in general, a fixed percent of General Fund revenues ("Test 1"), (b) the amount appropriated to K-14 schools in the prior year, adjusted for changes in the cost of living (measured as in Article XIII B by reference to State per capita personal income) and enrollment ("Test 2"), or (c) a third test, which would replace Test 2 in any year when the percentage growth in per capita General Fund revenues from the prior year plus one half of one percent is less than the percentage growth in State per capita personal income ("Test 3"). Under Test 3, schools would receive the amount appropriated in the prior year adjusted for changes in enrollment and per capita General Fund revenues, plus an additional small adjustment factor. If Test 3 is used in any year, the difference between Test 3 and Test 2 would become a "credit" to schools which would be the basis of payments in future years when per capita General Fund revenue growth exceeds per capita personal income growth. Legislation adopted prior to the end of the 1988-89 Fiscal Year, implementing Proposition 98, determined the K-14 schools' funding guarantee under Test 1 to be 40.3 percent of the General Fund tax revenues, based on 1986-87 appropriations. However, that percent has been adjusted to approximately 35 percent to account for a subsequent redirection of local property taxes, since such redirection directly affects the share of General Fund revenues to schools.

Proposition 98 permits the Legislature by two-thirds vote of both houses, with the Governor's concurrence, to suspend the K-14 schools' minimum funding formula for a one-year period. Proposition 98 also contains provisions transferring certain State tax revenues in excess of the Article XIII B limit to K-14 schools (see "State Finances--State Appropriations Limit" above).

During the recession in the early 1990s, General Fund revenues for several years were less than originally projected, so that the original Proposition 98 appropriations turned out to be higher than the minimum percentage provided in the law. The Legislature responded to these developments by designating the "extra" Proposition 98 payments in one year as a "loan" from future years' Proposition 98 entitlements, and also intended that the "extra" payments would not be included in the Proposition 98 "base" for calculating future years' entitlements. By implementing these actions, per-pupil funding from Proposition 98 sources stayed almost constant at approximately \$4,200 from Fiscal Year 1991-92 to Fiscal Year 1993-94.

In 1992, a lawsuit was filed, called *California Teachers' Association v. Gould*, which challenged the validity of these off-budget loans. The settlement of this case, finalized in July, 1996, provides, among other things, that both the State and K-14 schools share in the repayment of prior years' emergency loans to schools. Of the total \$1.76 billion in loans, the State is repaying \$935 million by forgiveness of the amount owed, while schools will repay \$825 million. The State share of the repayment will be reflected as an appropriation above the current Proposition 98 base calculation. The schools' share of the repayment will count as appropriations that count toward satisfying the Proposition 98 guarantee, or from "below" the current base. Repayments are spread over the eight-year period of 1994-95 through 2001-02 to mitigate any adverse fiscal impact.

Substantially increased General Fund revenues, above initial budget projections, in the fiscal years 1994-95 through 1998-99 have resulted in retroactive increases in Proposition 98 appropriations from subsequent fiscal years' budgets. Because of the State's increasing revenues, per-pupil funding at the K-12 level has increased by about 44 percent from the level in place from 1991-92 through 1993-94, and is estimated at about \$6,025 per ADA in 1999-00. A significant amount of the "extra" Proposition 98 monies in the last few years has been allocated to special programs, most particularly an initiative to allow each classroom from grades K-3 to have no more than 20 pupils by the end of the 1997-98 school year. Furthermore, since General Fund revenue growth is expected to continue in 1999-00, there are also new initiatives to increase school safety, improve schools' accountability for pupil performance, provide additional textbooks to schools, fund deferred maintenance projects, increase beginning teacher's salaries and provide performance incentives to teachers. See "Current State Budget" for further discussion of education funding.

Sources of Tax Revenue

The following is a summary of the State's major revenue sources. Further information on State revenues is contained under "Current State Budget" and "State Finances -- Recent Tax Receipts" below.

Personal Income Tax

The California personal income tax, which in 1997-98 contributed about 51 percent of General Fund revenues and transfers, is closely modeled after the federal income tax law. It is imposed on net taxable income (gross income less exclusions and deductions). The tax is progressive with rates ranging from 1 to 9.3 percent. Personal, dependent and other credits are allowed against the gross tax liability. In addition, taxpayers may be subject to an alternative minimum tax (AMT) which is much like the federal AMT.

Taxes on capital gains realizations have become a larger component of personal income taxes in the last few years. For the 1998 tax year, capital gains are projected to be 16 percent of the total Personal Income Tax Liability, up from 8 percent in 1995.

The personal income tax is adjusted annually by the change in the consumer price index to prevent taxpayers from being pushed into higher tax brackets without a real increase in income.

Sales Tax

The sales tax is imposed upon retailers for the privilege of selling tangible personal property in California. Sales tax accounted for about 32 percent of General Fund revenue and transfers in 1997-98. Most retail sales and leases are subject to the tax. However, exemptions have been provided for certain essentials such as food for home consumption, prescription drugs, gas delivered through mains and electricity. Other exemptions provide relief for a variety of sales ranging from custom computer software to aircraft.

The breakdown of the basic 7.25 percent rate currently imposed on a statewide basis is:

- 5.00 percent represents the State General Fund tax rate.
- 2.00 percent is dedicated to cities and counties.
- 0.25 percent is dedicated to county transit systems.

Legislation in July 1991 raised the sales tax rate by 1.25 percent to its current level. Of this amount, 0.25 percent was added to the General Fund tax rate, and the balance was dedicated to cities and counties. One-half percent was a permanent addition to counties, but with the money earmarked to trust funds to pay for health and welfare programs whose administration was transferred to counties. Another 0.5 percent of the State General Fund tax rate that was scheduled to terminate after June 30, 1993, was extended until December 31, 1993, and allocated

to local agencies for public safety programs. Voters in a special election on November 2, 1993, approved a constitutional amendment to permanently extend this 0.5 percent sales tax for local public safety programs.

Currently, 0.25 percent of the state tax rate may be terminated upon certification by the Director of Finance that the balance in the budget reserve for two consecutive years will exceed 4 percent of General Fund revenues. The 0.25 percent rate can be reinstated if the Director of Finance subsequently determines that the reserve will not exceed 4 percent of General Fund revenues.

Bank and Corporation Tax

Bank and corporation tax revenues, which comprised about 11 percent of General Fund revenues and transfers in 1997-98, are derived from the following taxes:

1. The franchise tax and the corporate income tax are levied at an 8.84 percent rate on profits. The former is imposed on corporations for the privilege of doing business in California, while the latter is imposed on corporations that derive income from California sources but are not sufficiently present to be classified as doing business in the State.
2. Banks and other financial corporations are subject to the franchise tax plus an additional tax at the rate of 2 percent on their net income. This additional tax is in lieu of personal property taxes and business license taxes.
3. The alternative minimum tax (AMT) is similar to that in federal law. In general, the AMT is based on a higher level of net income computed by adding back certain tax preferences. This tax is imposed at a rate of 6.65 percent.
4. A minimum franchise tax of up to \$800 is imposed on corporations subject to the franchise tax but not on those subject to the corporate income tax. Beginning in 2000, all new corporations are exempted from the minimum franchise tax for the first two years of incorporation.
5. Sub-Chapter S corporations are taxed at 1.5 percent of profits.

Insurance Tax

The majority of insurance written in California is subject to a 2.35 percent gross premium tax. For insurers, this premium tax takes the place of all other state and local taxes except those on real property and motor vehicles. Exceptions to the 2.35 percent rate are certain pension and profit-sharing plans which are taxed at the lesser rate of 0.5 percent, surplus lines and nonadmitted insurance at 3 percent and ocean marine insurers at 5 percent of underwriting profits. Insurance taxes comprised approximately 2.2 percent of General Fund revenues and transfers in 1997-98.

Other Taxes

Other General Fund major taxes and licenses include: Estate, Inheritance and Gift Taxes, Cigarette Taxes, Alcoholic Beverage Taxes, Horse Racing Revenues and trailer coach license fees. These other sources totaled approximately 2.4 percent of General Fund revenues and transfers in the 1997-98 Fiscal Year.

Special Fund Revenues

The California Constitution, codes and statutes specify the uses of certain revenue. Such receipts are accounted for in various special funds. In general, special fund revenues comprise three categories of income:

1. Receipts from tax levies which are allocated to specified functions, such as motor vehicle taxes and fees and certain taxes on tobacco products.
2. Charges for special services to specific functions, including such items as business and professional license fees.
3. Rental royalties and other receipts designated for particular purposes (e.g., oil and gas royalties).

Motor vehicle related taxes and fees accounted for about 58 percent of all special fund revenues and transfers in 1997-98. Principal sources of this income are motor vehicle fuel taxes, registration and weight fees and vehicle license fees. During the 1997-98 Fiscal Year, \$8.4 billion was derived from the ownership or operation of motor vehicles. About \$4.8 billion of this revenue was returned to local governments. The remainder was available for various state programs related to transportation and services to vehicle owners. These amounts (as well as those shown below in the table "Comparative Yield of State Taxes--All Funds") include the additional fees and taxes derived from the passage of Proposition 111 in June 1990.

Chapter 322, Statutes of 1998, reduced vehicle license fees by 25 percent beginning January 1, 1999, and the 1999-2000 Budget cut the fees by an additional 10 percent for the calendar year 2000 only. In addition, the 1999-2000 Budget provided a one-year reduction in vehicle license fees for certain commercial motor vehicles. Vehicle license fees, over and above the costs of collection and refunds authorized by law, are constitutionally defined local revenues. A continuous appropriation from the General Fund replaces the vehicle license fee revenue that local governments would otherwise lose due to the fee reductions. If in any year the Legislature fails to appropriate enough funds to fully offset the then-applicable vehicle license fee reduction, the percentage offset will be reduced to assure that local governments are not disadvantaged. Therefore, the amount of revenue going to local governments will remain the same as under prior law.

In addition to the initial 25 percent reduction, Chapter 322 also sets out a series of "trigger" levels, so that the percentage fee reduction could be increased in annual stages up to a

maximum of 67.5 percent in 2003 depending on whether future General Fund revenues reach the target levels. In order for the next 10 percent fee reduction, which will result in a cumulative 35 percent cut from 1998 base levels, to go into effect permanently beginning calendar year 2001, General Fund revenues in FY 2000-01 would need to reach about \$65.5 billion.

On November 8, 1988, voters approved Proposition 99, which imposed, as of January 1, 1989, an additional 25 cents per pack excise tax on cigarettes, and a new, equivalent excise tax on other tobacco products. The initiative requires that funds from this tax be allocated to anti-tobacco education and research and indigent health services, and environmental and recreation programs. Legislation enacted in 1993 added an additional 2 cents per pack excise tax for the purpose of funding breast cancer research.

Beginning January 1, 1999, after voters approved a constitutional amendment (Proposition 10 of 1998), the excise tax imposed on distributors selling cigarettes in California was increased from 37 to 87 cents per package. At the same time, this amendment imposed a new excise tax on cigars, chewing tobacco, pipe tobacco, and snuff that was implemented at a rate "equivalent" to a 50 cent per pack tax on cigarettes. Proceeds of this new state excise tax are to be allocated primarily for early childhood development programs. Under current law, any increase in the tax on cigarettes automatically triggers an increase in the tax on other tobacco products. Thus, this amendment increased the excise tax on other tobacco products in total by the equivalent of a \$1 per pack increase in the tax on cigarettes.

Tobacco Litigation

In late 1998, the State signed a settlement agreement with the four major cigarette manufacturers, which was later ratified by a State court judge having jurisdiction over a pending lawsuit brought by the State against these companies. The settlement became final in late September, 1999. Under the settlement, the companies will pay California governments a total of approximately \$25 billion over a period of 25 years. In addition, payments of approximately \$1 billion per year will continue in perpetuity. Under the settlement, half of these moneys will be paid to the State and half to local governments (all counties and the cities of San Diego, Los Angeles, San Francisco and San Jose). The State's 1999-2000 Budget includes receipt of about \$560 million of these settlement moneys to the General Fund by June 30, 2000.

The specific amount to be received by the State and local governments is, however, subject to adjustment for a number of reasons. Various details in the settlement allow reduction of the companies' payments because of events such as certain federal government actions, or reductions in cigarette sales. In the event that any of the companies goes into bankruptcy, the State could seek to terminate the agreement with respect to those companies filing bankruptcy actions thereby reinstating all claims against those companies. The State may then pursue those claims in the bankruptcy litigation, or as otherwise provided by law. Also, several parties have brought a lawsuit challenging the settlement and seeking damages; see "Litigation" below.

Recent Tax Receipts

The following table shows the trend of major General Fund and total taxes per capita and per \$100 of personal income for the past four years and the current fiscal year.

Trend of State Taxes

<u>Fiscal Year</u>	<u>Taxes per Capita(a)</u>		<u>Taxes per \$100 of Personal Income</u>	
	<u>General Fund</u>	<u>Total</u>	<u>General Fund</u>	<u>Total</u>
1995-96.....	\$1,398.03	\$1,709.28	\$5.94	\$7.27
1996-97.....	1,480.87	1,803.40	6.01	7.32
1997-98.....	1,634.22	1,965.83	6.37	7.66
1998-99(b).....	1,716.07	2,049.95	6.37	7.61
1999-00(b)	1,797.56	2,125.35	6.36	7.53

(a) Data reflect population figures benchmarked to the 1990 Census.

(b) Estimated.

SOURCE: State of California, Department of Finance.

The following table gives the actual and estimated growth in revenues by major source for the last four years and the current fiscal year.

COMPARATIVE YIELD OF STATE TAXES—ALL FUNDS
1995-96 THROUGH 1999-00
(Modified Accrual Basis)
(Thousands of Dollars)

Year Ending June 30	Sales and Use(a)	Personal Income	Bank and Corporation (b)	Tobacco(c)	Inheri- tance, Estate and Gift	Insurance	Alcoholic Beverages	Horse Racing	Motor Vehicle Fuel(d)	Motor Vehicle Fees(e)
1996	19,088,313	20,877,687(f)	5,862,420	666,779	659,338	1,131,737	269,227	104,158	2,757,289	5,009,319
1997	20,111,743	23,275,990	5,788,414	665,415	599,255	1,199,554	271,065	90,627	2,824,589	5,260,355
1998	21,331,691	27,927,940	5,836,881	644,297	780,197	1,221,285	270,947	81,930	2,853,846	5,660,574
1999(g)	20,926,310(h)	30,502,000	5,522,000	938,500	863,000	1,252,000	270,900	59,892	2,951,252	5,374,725
2000(g)	22,144,676(h)	32,914,000	5,751,000	1,221,000	907,000	1,246,000	268,800	38,502	3,015,051	4,859,564

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- (a) For 1995-96 through 1997-98, numbers include local tax revenue from the 0.5 percent rate increase that the voters passed in November 1993, for local public safety services. For 1998-99 and 1999-00 the estimates do not include this revenue.
- (b) Includes the corporation income tax and, from 1996 through 1998, the unitary election fee.
- (c) Proposition 10 (November 1998) increased the cigarette tax to \$0.87 per pack and added the equivalent of \$1.00 tax to other tobacco products.
- (d) Motor vehicle fuel tax (gasoline), use fuel tax (diesel and other fuels), and jet fuel.
- (e) Registration and weight fees, motor vehicle license fees and other fees. Reflects a 25 percent reduction in vehicle license fees effective January 1, 1999.
- (f) Reflects temporary increase in top marginal rate to 11 percent, which reverted to 9.3 percent for tax years after January 1, 1996.
- (g) Estimated. See "Current State Budget."
- (h) As stated in footnote (a), the estimates for 1998-99 and 1999-00 do not include voter approved local revenue.

SOURCE:

1995-96 through 1997-98: State of California, Office of the State Controller.
1998-99 and 1999-00: State of California, Department of Finance.

State Expenditures

The following table summarizes the major categories of State expenditures, including both General Fund and special fund programs.

GOVERNMENTAL COST FUNDS (Budgetary Basis) Schedule of Expenditures by Function and Character 1993-94 to 1997-98 Fiscal Years (Thousands)					
	<u>1993-94</u>	<u>1994-95</u>	<u>1995-96</u>	<u>1996-97</u>	<u>1997-98</u>
Function					
Legislative, Judicial, Executive					
Legislative.....	\$ 175,792	\$ 180,769	\$ 187,768	\$ 196,642	\$ 209,690
Judicial.....	616,862	635,916	704,112	716,712	766,932
Executive.....	564,997	653,583	691,264	961,025	919,606
State and Consumer Services	630,515	697,555	749,368	734,238	771,444
Business, Transportation and Housing					
Business and Housing.....	224,217	225,398	243,185	115,089	136,558
Transportation.....	3,363,335	3,188,749	3,334,648	3,650,506	3,924,428
Trade and Commerce.....	34,122	47,595	51,280	63,789	62,235
Resources.....	1,088,492	1,141,488	1,179,481	1,310,074	1,323,860
Environmental Protection.....	510,274	459,492	505,206	507,156	605,584
Health and Welfare.....	15,953,388	16,675,380	17,275,117	17,987,919	18,059,611
Correctional Programs.....	3,074,471	3,280,762	3,638,672	3,606,674	3,901,296
Education					
Education-K through 12.....	13,820,462	14,973,978	16,773,927	19,916,015	21,574,341
Higher Education.....	4,951,535	5,436,640	5,844,282	6,599,573	7,022,658
General Government					
General Administration.....	1,015,089	1,000,650	672,935	743,024	764,615
Debt Service.....	1,802,833	2,189,529	2,153,682	2,048,475	1,979,211
Tax Relief.....	473,707	480,430	474,179	454,509	453,030
Shared Revenues.....	3,162,558	3,188,090	3,346,240	3,690,512	3,892,036
Other Statewide Expenditures	(129,338)	(92,508)	202,158	133,309	1,373,823
Expenditure Adjustment for					
Encumbrances.....	(162,958)	694,288	(7,691)	(190,609)	(162,630)
Credits for Overhead Services					
by General Fund.....	(184,336)	(156,118)	(130,016)	(147,019)	(125,678)
Statewide Indirect Cost					
Recoveries.....	<u>(35,399)</u>	<u>(31,132)</u>	<u>(48,730)</u>	<u>(23,307)</u>	<u>(48,963)</u>
Total.....	<u>\$50,950,618</u>	<u>\$54,870,534</u>	<u>\$57,841,067</u>	<u>\$63,074,306</u>	<u>\$67,403,687</u>
Character					
State Operations.....	\$15,322,082	\$16,403,401	\$17,341,247	\$17,924,850	\$20,199,031
Local Assistance.....	35,166,791	37,680,952	39,973,320	44,686,447	46,666,925
Capital Outlay.....	<u>461,745</u>	<u>786,181</u>	<u>526,500</u>	<u>463,009</u>	<u>537,731</u>
Total.....	<u>\$50,950,618</u>	<u>\$54,870,534</u>	<u>\$57,841,067</u>	<u>\$63,074,306</u>	<u>\$67,403,687</u>

SOURCE: State of California, Office of the State Controller.

PRIOR FISCAL YEARS' FINANCIAL RESULTS

The State's financial condition improved markedly during the fiscal years starting in 1995-96, with a combination of better than expected revenues, slowdown in growth of social welfare programs, and continued spending restraint based on actions taken in earlier years. The State's cash position also improved, and no external deficit borrowing occurred over the end of the last four fiscal years. The last borrowing to spread out the repayment of a budget deficit over the end of a fiscal year was \$4.0 billion of revenue anticipation warrants issued in July, 1994 and which matured in April, 1996. See "State Indebtedness-Cash Flow Borrowings" above.

The economy grew strongly during the fiscal years beginning in 1995-96, and as a result, the General Fund took in substantially greater tax revenues (around \$2.2 billion in 1995-96, \$1.6 billion in 1996-97 and \$2.4 billion in 1997-98 and \$1.0 billion in 1998-99) than were initially planned when the budgets were enacted. The accumulated budget deficit from the recession years was finally eliminated with the repayment of the revenue anticipation warrants in April, 1996. These additional funds were largely directed to school spending as mandated by Proposition 98, to make up shortfalls from reduced federal health and welfare aid in 1995-96 and 1996-97 and particularly in 1998-99 to fund new program incentives.

The following were major features of the 1998 Budget Act and certain additional fiscal bills enacted before the end of the legislative session:

1. The most significant feature of the 1998-99 budget was agreement on a total of \$1.4 billion of tax cuts. The central element was a bill which provided for a phased-in reduction of the Vehicle License Fee ("VLF"). Since the VLF is transferred to cities and counties under existing law, the bill provided for the General Fund to replace the lost revenues. Starting on January 1, 1999, the VLF has been reduced by 25 percent, at a cost to the General Fund of approximately \$500 million in the 1998-99 Fiscal Year and about \$1 billion annually thereafter. See "State Finances – Sources of Tax Revenue – Special Fund Revenues" above.

In addition to the cut in VLF, the 1998-99 budget included both temporary and permanent increases in the personal income tax dependent credit (\$612 million General Fund cost in 1998-99, but less in future years), a nonrefundable renters tax credit (\$133 million), and various targeted business tax credits (\$106 million).

2. Proposition 98 funding for K-14 schools was increased by \$1.7 billion in General Fund moneys over revised 1997-98 levels, over \$300 million higher than the minimum Proposition 98 guarantee. Of the 1998-99 funds, major new programs included money for instructional and library materials, deferred maintenance, support for increasing the school year to 180 days and reduction of class sizes in Grade 9. The Budget also included \$250 million as repayment of prior years' loans to schools, as part of the settlement of the *CTA v. Gould* lawsuit. (See "State Finances - Proposition 98" above.)

3. Funding for higher education increased substantially above the actual 1997-98 level. General Fund support was increased by \$340 million (15.6 percent) for the University of California and \$267 million (14.1 percent) for the California State University system. In addition, Community Colleges funding increased by \$300 million (6.6 percent).

4. The Budget included increased funding for health, welfare and social services programs. A 4.9 percent grant increase was included in the basic welfare grants, the first increase in those grants in 9 years.

5. Funding for the judiciary and criminal justice programs increased by about 11 percent over 1997-98, primarily to reflect increased State support for local trial courts and rising prison population.

6. Major legislation enacted after the 1998 Budget Act included new funding for resources projects, a share of the purchase of the Headwaters Forest, funding for the Infrastructure and Economic Development Bank (\$50 million) and funding for the construction of local jails. The State realized savings of \$433 million from a reduction in the State's contribution to the State Teacher's Retirement System in 1998-99.

The May Revision to the 1999-2000 Governor's Budget (hereafter shortened to "1999-00"), released on May 14, 1999 (the "1999 May Revision"), reported that stronger than expected economic conditions in the State for the latter part of 1998 and into 1999 would produce total 1998-99 General Fund revenues of about \$57.9 billion, almost \$1.0 billion above the 1998 Budget Act estimates and \$1.6 billion above the initial estimates in the January 1999-2000 Governor's Budget. The 1999 May Revision projects 1998-99 General Fund expenditures of \$58.6 billion, about \$400 million higher than the January 1999-2000 Governor's Budget estimate. Some of this additional revenue will be directed to K-14 schools pursuant to Proposition 98. The 1999 May Revision projected a balance in the SFEU at June 30, 1999, of approximately \$1.9 billion, \$1.3 billion higher than estimated in January.

CURRENT STATE BUDGET

The discussion below of the 1999-00 Fiscal Year budget and the table under "Summary of State Revenues and Expenditures" are based on estimates and projections of revenues and expenditures for the current fiscal year and must not be construed as statements of fact. These estimates and projections are based upon various assumptions as updated in the 1999 Budget Act, which may be affected by numerous factors, including future economic conditions in the State and the nation, and there can be no assurance that the estimates will be achieved. See "Current State Budget -- Revenue and Expenditure Assumptions" below.

Periodic reports on revenues and/or expenditures during the fiscal year are issued by the Administration, the State Controller's Office and the Legislative Analyst's Office. The Department of Finance issues a monthly Bulletin which reports the most recent revenue receipts as reported by state departments, comparing them to Budget projections. The Administration also formally updates its budget projections three times during each fiscal year, in January, May, and at budget enactment. These bulletins and other reports are available on the Internet at the following websites:

Department of Finance
State Controller
Legislative Analyst

www.dof.ca.gov
www.sco.ca.gov
www.lao.ca.gov

1999-2000 Fiscal Year Budget

On January 8, 1999, Governor Davis released his proposed budget for Fiscal Year 1999-00 (the "January Governor's Budget"). The January Governor's Budget generally reported that general fund revenues for FY 1998-99 and FY 1999-00 would be lower than earlier projections (primarily due to weaker overseas economic conditions perceived in late 1998), while some caseloads would be higher than earlier projections. The January Governor's Budget proposed \$60.5 billion of general fund expenditures in FY 1999-00, with a \$415 million SFEU reserve at June 30, 2000.

The 1999 May Revision showed an additional \$4.3 billion of revenues for combined fiscal years 1998-99 and 1999-00. The completion of the 1999 Budget Act occurred in a timely fashion. The final Budget Bill was adopted by the Legislature on June 16, 1999, and was signed by the Governor on June 29, 1999 (the "1999 Budget Act"), meeting the Constitutional deadline for budget enactment for only the second time in the 1990's.

The final 1999 Budget Act estimated General Fund revenues and transfers of \$63.0 billion, and contained expenditures totaling \$63.7 billion after the Governor used his line-item veto to reduce the legislative Budget Bill expenditures by \$581 million (both General Fund and Special Fund). The 1999 Budget Act also contained expenditures of \$16.1 billion from special funds and \$1.5 billion from bond funds. The Administration estimated that the SFEU would have a balance at June 30, 2000, of about \$880 million. Not included in this amount was an additional \$300 million which (after the Governor's vetoes) was "set aside" to provide funds for employee salary increases (to be negotiated in bargaining with employee unions), and for litigation reserves. The 1999 Budget Act anticipates normal cash flow borrowing during the fiscal year. See "State Indebtedness-Cash Flow Borrowings."

The principal features of the 1999 Budget Act include the following:

1. Proposition 98 funding for K-12 schools was increased by \$1.6 billion in General Fund moneys over revised 1998-99 levels, \$108.6 million higher than the minimum Proposition 98 guarantee. Of the 1999-00 funds, major new programs included money for reading improvement, new textbooks, school safety, improving teacher quality, funding teacher bonuses, providing greater accountability for school performance, increasing preschool and after school care programs and funding deferred maintenance of school facilities. The Budget also includes \$310 million as repayment of prior years' loans to schools, as part of the settlement of the *CTA v. Gould* lawsuit. See also "State Finances – Proposition 98" above.

2. Funding for higher education increased substantially above the actual 1998-99 level. General Fund support was increased by \$184 million (7.3 percent) for the University of California and \$126 million (5.9 percent) for the California State University system. In addition, Community Colleges funding increased by \$324.3 million (6.6 percent). As a result, undergraduate fees at UC and CSU will be reduced for the second consecutive year, and the per-unit charge at Community Colleges will be reduced by \$1.

3. The Budget included increased funding of nearly \$600 million for health and human services.

4. About \$800 million from the general fund will be directed toward infrastructure costs, including \$425 million in additional funding for the Infrastructure Bank, initial planning costs for a new prison in the Central Valley, additional equipment for train and ferry service, and payment of deferred maintenance for state parks.

5. The Legislature enacted a one-year additional reduction of 10 percent of the VLF for calendar year 2000, at a General Fund cost of about \$250 million in each of FY 1999-00 and 2000-01 to make up lost funding to local governments. Conversion of this one-time reduction to a permanent cut will remain subject to the revenue tests in the legislation adopted last year. See "State Finances – Sources of Tax Revenue – Special Fund Revenue" above. Several other targeted tax cuts, primarily for businesses, were also approved, at a cost of \$54 million in 1999-00.

6. A one-time appropriation of \$150 million, to be split between cities and counties, was made to offset property tax shifts during the early 1990's. Additionally, an ongoing \$50 million was appropriated as a subvention to cities for jail booking or processing fees charged by counties when an individual arrested by city personnel is taken to a county detention facility.

Summary of State Revenues and Expenditures

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE—GENERAL FUND (Budgetary Basis)(a) FISCAL YEARS 1995-96 THROUGH 1999-00 (Millions)

	1995-96	1996-97	1997-98	Estimated ^(b) 1998-99	1999-00
Fund Balance—Beginning of Period	\$ (393.8)	\$ 1,073.9	\$ 639.8	\$ 2,792.5	\$ 2,412.2
Restatements					
Prior Year Revenue, Transfer					
Accrual Adjustments.....	(5.3)	(59.0)	(165.3)	30.8	--
Prior Year Expenditure, Accrual Adjustments.....	118.9	88.8	498.1	240.8	--
Fund Balance—Beginning of Period, as Restated	<u>\$ (280.2)</u>	<u>\$ 1,103.7</u>	<u>\$ 972.6</u>	<u>\$ 3,064.1</u>	<u>\$ 2,412.2</u>
Revenues.....	\$ 46,082.1	\$ 49,161.4	\$ 54,797.7	\$ 58,209.9	\$ 62,719.6
Other Financing Sources					
Transfers from Other Funds.....	4,540.8 ^(c)	181.5	132.0	(282.6)	261.3
Other Additions.....	<u>61.4</u>	<u>49.3</u>	<u>154.4</u>	<u>--</u>	<u>--</u>
Total Revenues and Other Sources	<u>\$ 50,684.3</u>	<u>\$ 49,392.2</u>	<u>\$ 55,084.1</u>	<u>\$ 57,927.3</u>	<u>\$ 62,980.9</u>
Expenditures					
State Operations.....	\$ 11,687.7	\$ 12,151.5	\$ 14,042.1	\$ 14,693.7	\$ 15,313.0
Local Assistance.....	33,132.5	37,433.8	38,990.4	43,508.4	48,036.8
Capital Outlay.....	28.9	53.5	57.2	376.7	383.1
Unclassified.....	--	--	--	0.4	--
Other Uses					
Transfer to Other Funds.....	<u>4,481.1^(c)</u>	<u>217.3</u>	<u>174.5</u>	<u>--^(d)</u>	<u>--^(d)</u>
Total Expenditures and Other Uses	<u>\$ 49,330.2</u>	<u>\$ 49,856.1</u>	<u>\$ 53,264.2</u>	<u>\$ 58,579.2</u>	<u>\$ 63,732.9</u>
Revenues and Other Sources Over or (Under) Expenditures and Other Uses	<u>\$ 1,354.1</u>	<u>\$ (463.9)</u>	<u>\$ 1,819.9</u>	<u>\$ (651.9)</u>	<u>\$ (752.0)</u>
Fund Balance					
Reserved for Encumbrances.....	\$ 450.8	\$ 442.4	\$ 478.7	\$ 480.0	\$ 480.0
Reserved for Unencumbered Balances of Continuing Appropriations ^(e)	123.0	68.1	122.8	568.3	476.9
Reserved for School Loans ^(f)	1,609.7	1,459.7	1,259.7	1,009.7	699.7
Unreserved—Undesignated ^(g)	<u>(1,109.6)</u>	<u>(1,330.4)</u>	<u>931.3</u>	<u>354.2</u>	<u>3.6</u>
Fund Balance—End of Period	\$ 1,073.9	\$ 639.8	\$ 2,792.5	\$ 2,412.2	\$ 1,660.2

Footnotes on following page.

SOURCE: Fiscal Years 1995-96 to 1997-98: State of California, Office of the State Controller.
Fiscal Years 1998-99 and 1999-00: State of California, Department of Finance.

- (a) These statements have been prepared on a budgetary basis in accordance with State law and some modifications would be necessary in order to comply with generally accepted accounting principles ("GAAP"). The audited general purpose financial statements of the State contain a description of the differences between the budgetary basis and the GAAP basis of accounting. See "Financial Statements."
- (b) Estimates are shown net of reimbursements and abatements.
- (c) \$4.2 billion was transferred from the General Fund to the Warrant Payment Fund in four installments on specified dates in the 1995-96 fiscal year. On April 25, 1996, the \$4.2 billion was transferred back to the General Fund from the Warrant Payment Fund to pay and redeem at maturity \$4.0 billion of 1994 Revenue Anticipation Warrants, Series C and D.
- (d) "Transfer to Other Funds" is included either in the expenditure totals detailed above or as "Transfer from Other Funds."
- (e) For purposes of determining whether the General Fund budget, in any given fiscal year, is in a surplus or deficit condition, Chapter 1238, Statutes of 1990, amended Government Code Section 13307. As part of the amendment, the unencumbered balances of continuing appropriations which exist when no commitment for an expenditure is made should be an item of disclosure, but the amount shall not be deducted from the fund balance. Accordingly, the General Fund condition included in the 1999-00 Governor's Budget includes the unencumbered balances of continuing appropriations as a footnote to the statement (\$568.3 million in 1998-99 and \$476.9 million in 1999-00). However, in accordance with Government Code Section 12460, the State's Budgetary/Legal Basis Annual Report reflects a specific reserve for the unencumbered balance for continuing appropriations.
- (f) During 1995, a reserve was established in the General Fund balance for the \$1.7 billion of previously recorded school loans which had been authorized by Chapter 703, Statutes of 1992 and Chapter 66, Statutes of 1993. These loans are deferred and are to be repaid from future General Fund appropriations. See "State Finances - Proposition 98" above for a discussion of the settlement of the CTA v. Gould lawsuit. This accounting treatment is consistent with the State's audited financial statements prepared in accordance with GAAP.
- (g) Includes Special Fund For Economic Uncertainties (SFEU). The State Controller reports the balance in the SFEU as of June 30, 1998, to be \$931.3 million in compliance with Government Code §16418(e) (see "State Finances – The Special Fund for Economic Uncertainties"). Therefore, the Undesignated-Unreserved fund balance at June 30, 1998, is \$0. The Department of Finance estimates a total SFEU balance of \$1,932 million on June 30, 1999, and \$880 million on June 30, 2000. Additionally, the 1999 Budget Act includes a set aside in 1999-00 in the amount of \$300 million for employee compensation and litigation.

Revenue and Expenditure Assumptions

The table below presents the Department of Finance's budget basis statements of major General Fund revenue sources and expenditures for the 1997-98 and 1998-99 Fiscal Years and the Budget Act estimates for the 1999-00 Fiscal Year.

<u>Source</u>	Revenues (Millions)			
	Actual Fiscal Year <u>1997-98*</u>	Original Fiscal Year <u>1998-99*</u>	Revised Fiscal Year <u>1998-99†</u>	Enacted Fiscal Year <u>1999-00†</u>
Personal Income Tax.....	\$27,925	\$28,963	\$30,502	\$32,914
Sales and Use Tax.....	17,583	18,739	18,860	19,960
Bank and Corporation Tax.....	5,837	6,100	5,522	5,751
Insurance Tax.....	1,221	1,281	1,252	1,246
All Other.....	<u>2,407</u>	<u>1,902</u>	<u>1,791</u>	<u>3,110</u>
Total Revenues and Transfers	<u>\$54,973</u>	<u>\$56,985</u>	<u>\$57,927</u>	<u>\$62,981</u>

<u>Function</u>	Expenditures (Millions)			
	Actual Fiscal Year <u>1997-98*</u>	Original Fiscal Year <u>1998-99*</u>	Revised Fiscal Year <u>1998-99†</u>	Enacted Fiscal Year <u>1999-00†</u>
K-12 Education.....	\$22,080	\$23,847	\$23,772	\$26,418
Health and Human Services.....	14,639	15,343	16,335	16,921
Higher Education.....	6,625	7,561	7,438	8,011
Youth and Adult Correctional.....	4,139	4,443	4,557	4,739
Legislative, Judicial and Executive.....	1,569 (a)	1,808	1,893	2,195
Tax Relief.....	454	994	1,022	1,868
Resources.....	718	1,086	1,203	1,272
State and Consumer Services.....	394	438	448	482
Business, Transportation and Housing.....	274	359	298	412
All Other.....	<u>1,982 (b)</u>	<u>1,383</u>	<u>1,613</u>	<u>1,415</u>
Total Expenditures	<u>\$52,874</u>	<u>\$57,262</u>	<u>\$58,579</u>	<u>\$63,733</u>

(a) Includes expenditure of fine and penalty revenue up to December 31, 1997, for support of Trial Courts.

(b) Includes \$1.2 billion for payment to Public Employees Retirement Fund in response to legal judgment.

* 1998 Budget Act.

† 1999 Budget Act, June 29, 1999.

SOURCE: State of California, Department of Finance.

Economic Assumptions

The Revenue and Expenditure assumptions set forth have been based upon certain estimates of the performance of the California and national economies in calendar years 1999 and 2000. In the Governor's May Revision released on May 14, 1999, the Department of Finance projected that the California economy will show strong growth in 1999, but slow down in 2000. The economic expansion has been marked by strong growth in high technology business services (including computer software), construction, and tourism related industries. The Asian economic crisis, which began in 1997, has tended to dampen the State's economic growth, particularly in high technology manufacturing. However, improving economic conditions in Asia, ongoing strength in NAFTA partners, and growth in Europe, combined with ongoing strength in stock markets, have improved the short-term outlook.

The Department set out the following estimates for California's economic performance which were used in predicting revenues and expenditures for the May Revision of the Governor's 1999-00 Fiscal Year Budget. Also shown was the Department's previous forecast for 1999 and 2000, contained in the 1999-2000 Governor's Budget.

	For 1999		For 2000	
	<u>Governor's Budget*</u>	<u>May Revision†</u>	<u>Governor's Budget*</u>	<u>May Revision</u>
Nonfarm wage and salary employment (000)	13,873	14,046	14,205	14,393
Percent Change	2.1	3.3	2.4	2.5
Personal income (\$ billions)	945.5	961.6	997.1	1,013.4
Percent Change	5.1	6.6	5.5	5.4
Housing Permits (Units 000)	152	160	166	174
Consumer Price Index (% change)	2.4	2.8	3.0	2.7

* January 8, 1999 (for "Governor's Budget").

† May 14, 1999 (for "May Revision").

SOURCE: State of California, Department of Finance.

FINANCIAL STATEMENTS

Audited General Purpose Financial Statements of the State of California (the “Financial Statements”) are available for the Fiscal Year ended June 30, 1998. Such Financial Statements have been filed with all of the Nationally Recognized Municipal Securities Information Repositories, as part of the Official Statements for State General Obligation Bonds sold previously during this year, and are incorporated by reference into this Appendix. Potential investors may obtain or review a copy of the Financial Statements from the following sources:

1. By obtaining from any Nationally Recognized Municipal Securities Information Repository, or any other source, a copy of the State of California’s Official Statement dated June 9, 1999 relating to the issuance of \$400,000,000 of General Obligation Bonds. The Financial Statements are printed in full in such Official Statement. No part of the June 9, 1999 Official Statement *except* the Financial Statements is incorporated into this document.
2. By accessing the Internet Website of the State Controller (www.sco.ca.gov) and clicking on the icons for “Publications;” “State and Local Government Financial Reports;” and “Comprehensive Annual Financial Report – 1998” in that order or by contacting the Office of the State Controller at (916) 445-2636.
3. By accessing the Internet Website of the State Treasurer (www.treasurer.ca.gov) and clicking on the icons for “Financial Information” and “Audited General Purpose Financial Statements” in that order, or by contacting the Office of the State Treasurer at (800) 900-3873.

Certain unaudited financial information for the Fiscal Year ended June 30, 1999 is included as an Exhibit to Appendix A.

ECONOMY AND POPULATION

Introduction

California’s economy, the largest among the 50 states and one of the largest in the world, has major components in high technology, trade, entertainment, agriculture, manufacturing, tourism, construction and services. Since 1994, California’s economy has been performing strongly after suffering a deep recession between 1990-94.

Population and Labor Force

The State’s July 1, 1998 population of over 33.4 million represented over 12 percent of the total United States population.

California's population is concentrated in metropolitan areas. As of the April 1, 1990 census, 96 percent resided in the 23 Metropolitan Statistical Areas in the State. As of July 1, 1998, the 5-county Los Angeles area accounted for 49 percent of the State's population, with over 16.0 million residents, and the 10-county San Francisco Bay Area represented 21 percent, with a population of over 7.0 million.

The following table shows California's population data for 1994 through 1998.

Population 1994-98					
<u>Year</u>	<u>California Population</u>^(a)	<u>% Increase Over Preceding Year</u>	<u>United States Population</u>^(a)	<u>% Increase Over Preceding Year</u>	<u>California as % of United States</u>
1994	31,790,000	0.9	260,292,000	1.0	12.2
1995	32,063,000	0.9	262,761,000	0.9	12.2
1996	32,383,000	1.0	265,179,000	0.9	12.2
1997	32,957,000	1.8	267,636,000	0.9	12.3
1998	33,494,000	1.6	270,029,000	0.9	12.4

^(a) Population as of July 1.

SOURCE: U.S. Department of Commerce, Bureau of the Census; State of California, Department of Finance.

The following table presents civilian labor force data for the resident population, age 16 and over, for the years 1993 to 1998.

Labor Force 1993-98

<u>Year</u>	<u>Labor Force Trends (Thousands)</u>		<u>Unemployment Rate (%)</u>	
	<u>Labor Force</u>	<u>Employment</u>	<u>California</u>	<u>United States</u>
1993	15,359	13,918	9.4	6.9
1994	15,450	14,122	8.6	6.1
1995	15,412	14,203	7.8	5.6
1996	15,511	14,391	7.2	5.4
1997	15,941	14,937	6.3	4.9
1998	16,330	15,361	5.9	4.5

SOURCE: State of California, Employment Development Department.

Employment, Income, Construction and Export Growth

The following table shows California's nonagricultural employment distribution and growth for 1990 and 1998.

Payroll Employment By Major Sector 1990 and 1998

<u>Industry Sector</u>	<u>Employment (Thousands)</u>		<u>% Distribution of Employment</u>	
	<u>1990</u>	<u>1998</u>	<u>1990</u>	<u>1998</u>
Mining	39	25	0.3	0.2
Construction	605	602	4.8	4.4
Manufacturing				
Nondurable goods	721	729	5.7	5.4
High Technology	686	534	5.4	3.9
Other Durable goods	690	697	5.4	5.1
Transportation and Utilities	624	694	4.9	5.1
Wholesale and Retail Trade	3,002	3,122	23.7	23.0
Finance, Insurance				
And Real Estate	825	798	6.5	5.9
Services	3,395	4,220	26.8	31.1
Government				
Federal	362	269	2.9	2.0
State and Local	<u>1,713</u>	<u>1,894</u>	<u>13.5</u>	<u>13.9</u>
TOTAL				
NONAGRICULTURAL	<u>12,662</u>	<u>13,584</u>	<u>100</u>	<u>100</u>

SOURCE: State of California, Employment Development Department and State of California, Department of Finance.

The following tables show California's total and per capita income patterns for selected years.

Total Personal Income 1993-98

<u>California</u>			California
<u>Year</u>	<u>Millions</u>	<u>% Change</u>	<u>% of U.S.</u>
1993	\$698,130	2.0*	12.8
1994 ^a	718,321	2.9	12.5
1995	754,269	5.0	12.4
1996	798,020	5.8	12.5
1997	846,017	6.0	12.5
1998 ^b	904,444	6.9	12.7

* Change from prior year.

^a Reflects Northridge earthquake, which caused an estimated \$15 billion drop in personal income.

^b Estimated by the State of California, Department of Finance.

Note: Omits income for government employees overseas.

SOURCE: U.S. Department of Commerce, Bureau of Economic Analysis.

Per Capita Personal Income 1993-98

<u>Year</u>	<u>California</u>	<u>% Change</u>	<u>United States</u>	<u>% Change</u>	California % of U.S.
1993	\$22,388	1.0*	\$21,220	3.3*	105.5
1994 ^a	22,899	2.3	22,056	3.9	103.8
1995	23,901	4.4	23,063	4.6	103.6
1996	25,050	4.8	24,169	4.8	103.6
1997	26,218	4.7	25,298	4.7	103.6
1998	27,116 ^b	3.4	26,368 ^c	4.2	102.8

* Change from prior year

^a Reflects Northridge earthquake, which caused an estimated \$15 billion drop in personal income.

^b Estimated by the State of California, Department of Finance.

^c Estimated by the U.S. Department of Commerce, Bureau of Economic Analysis.

SOURCE: U.S. Department of Commerce, Bureau of Economic Analysis.

The following tables show California's residential and nonresidential construction authorized by permits for selected years.

Residential Construction Authorized by Permits

<u>Year</u>	<u>Units</u>			<u>Valuation a/ (\$ mill.)</u>
	<u>Total</u>	<u>Single</u>	<u>Multiple</u>	
1994	97,047	77,115	19,932	14,852
1995	85,293	68,689	16,604	13,879
1996	94,283	74,923	19,360	15,289
1997	111,716	84,780	26,936	18,752
1998	125,707	94,298	31,409	21,976

a/ Valuation includes additions and alterations.

SOURCE: Construction Industry Research Board

**Nonresidential Construction
(Thousands of dollars)**

<u>Year</u>	<u>Commercial</u>	<u>Industrial</u>	<u>Other</u>	<u>Additions and Alterations</u>	<u>Total</u>
1994	2,108,067	649,632	1,051,276	4,080,657	7,889,631
1995	2,308,912	732,877	1,050,684	4,062,271	8,154,744
1996	2,751,909	1,140,575	1,152,425	4,539,219	9,584,127
1997	4,271,373	1,598,421	1,378,200	5,021,796	12,269,790
1998	5,419,246	2,466,523	1,717,936	5,307,891	14,911,596

SOURCE: Construction Industry Research Board

The following tables show California's export growth for the period from 1993 through 1998.

**Exports Through California Ports
(In millions)**

<u>Year</u>	<u>Exports a/</u>	<u>% Change</u>
1993	\$82,173.5	1.3%
1994	\$95,614.6	16.4%
1995	\$116,825.5	22.2%
1996	\$124,120.0	6.2%
1997	\$131,142.7	5.7%
1998	\$116,282.4	-11.3%

a/ "free along ship" Value Basis

SOURCE: U.S. Department of Commerce, Bureau of the Census

LITIGATION

The State is a party to numerous legal proceedings. The following are the most significant pending proceedings, as reported by the Office of the Attorney General. None of these proceedings, if determined adversely to the State, would affect the State's ability to pay when due the principal or interest on the obligations offered by this Official Statement.

Following are the more significant lawsuits pending against the State:

On December 24, 1997, a consortium of California counties filed a test claim with the Commission on State Mandates (the "Commission") asking the Commission to determine whether the property tax shift from counties to school districts beginning in 1993-94, is a reimbursable state mandated cost. See "State Finances – Local Governments" above. The test claim was heard on October 29, 1998, and the Commission on State Mandates found in favor of the State. In March, 1999, Sonoma County filed suit in the Superior Court to overturn the Commission's decision. In October, 1999, a Sonoma County Superior Court Judge ruled in favor of the County. The State will continue to contest this lawsuit. Should the courts ultimately find in favor of the counties, the impact to the State General Fund could be as high as \$10.0 billion. In addition, there would be an annual Proposition 98 General Fund cost of at least \$3.75 billion. This cost would grow in accordance with the annual assessed value growth rate.

On June 24, 1998, plaintiffs in *Howard Jarvis Taxpayers Association et al. v. Kathleen Connell* filed a complaint for certain declaratory and injunctive relief challenging the authority of the State Controller to make payments from the State Treasury in the absence of a state budget. On July 21, 1998, the trial court issued a preliminary injunction prohibiting the State Controller from paying moneys from the State Treasury for fiscal year 1998-99, with certain limited

exceptions, in the absence of a state budget. The preliminary injunction, among other things, prohibited the State Controller from making any payments pursuant to any continuing appropriation. On July 22 and 27, 1998, various employee unions which had intervened in the case appealed the trial court's preliminary injunction and asked the Court of Appeal to stay the preliminary injunction. On July 28, 1998, the Court of Appeal granted the unions' requests and stayed the preliminary injunction pending the Court of Appeal's decision on the merits of the appeal. On August 5, 1998, the Court of Appeal denied the plaintiffs' request to reconsider the stay. Also on July 22, 1998, the State Controller asked the California Supreme Court to immediately stay the trial court's preliminary injunction and to overrule the order granting the preliminary injunction on the merits. On July 29, 1998, the Supreme Court transferred the State Controller's request to the Court of Appeal. The matters are now pending before the Court of Appeal. Briefs have been submitted; no date has yet been set for oral argument.

The State is involved in a lawsuit, *Thomas Hayes v. Commission on State Mandates*, related to state-mandated costs. The action involves an appeal by the Director of Finance from a 1984 decision by the State Board of Control (now succeeded by the Commission on State Mandates (COSM)). The Board of Control decided in favor of local school districts' claims for reimbursement for special education programs for handicapped students. The case was then brought to the trial court by the State and later remanded to the COSM for redetermination. The COSM has since expanded the claim to include supplemental claims filed by several other institutions. To date, the Legislature has not appropriated funds. The liability to the State, if all potentially eligible school districts pursue timely claims, has been estimated by the Department of Finance at more than \$1 billion. The Commission on State Mandates issued a decision in December 1998 determining that a small number of components of the State's special education program are state mandated local costs. The administrative proceeding is in the "parameters and guidelines" stage where the commission is considering whether and to what extent the costs associated with the state mandated components of the special education program are offset by funds that the State already allocates to that program. The State's position is that all costs are offset by existing funding. The State has the option to seek judicial review of the mandate finding.

In *Capitola Land v. Anderson* and other related state and federal cases, plaintiffs sought payments from the State under the AFDC-Foster Care program. Judgment was rendered against the State in *Capitola*, which the State appealed and lost. The State then filed a state plan amendment with the federal Department of Health and Human Services ("DHHS") to enable the State to comply with the *Capitola* ruling and receive federal funding. The DHHS denied the state plan amendment, and the State has filed suit against DHHS. The State Legislature enacted a statute that conditioned State compliance with the *Capitola* judgment on receipt of federal funding (50% contribution). The State then refused to implement the *Capitola* judgment based on the new statute. Certain plaintiffs moved for an order of contempt against the State, which was granted by the trial court, but was stayed and annulled by the Court of Appeal. The plaintiffs' petition for review was denied by the California Supreme Court. However, the State continues to pursue federal funding in federal court. If, as a result of this litigation, compliance with the *Capitola* judgment is required and the judgment is applied retroactively, liability to the State could exceed \$200 million.

In January of 1997, California experienced major flooding in six different areas with preliminary estimates of property damage of approximately \$1.6 to \$2.0 billion. A substantial number of plaintiffs have joined suit against the State, local agencies, and private companies and contractors seeking compensation for the damages they suffered as a result of the 1997 flooding. The State is vigorously defending the action.

In *Just Say No to Tobacco Dough Campaign v. State of California*, the petitioners challenge the appropriation of approximately \$166 million of Proposition 99 funds in the Cigarette and Tobacco Products Surtax Fund for years ended June 30, 1990, through June 30, 1995, for related disease research. If the State loses, the General Fund and funds from other sources would be used to reimburse the Cigarette and Tobacco Products Surtax Fund, an agency fund, for approximately \$166 million. However, the superior court issued an order in December 1998, granting the State's demurrer to the entire action and dismissing the case. The superior court thereafter reconsidered its ruling and allowed plaintiffs to amend their complaint. The State demurred to the amended complaint. In July, 1999, the court again sustained the State's demurrer to the amended complaint, and issued a judgment dismissing the case. Plaintiffs appealed. The matter will be briefed and will be scheduled for oral argument before the court.

The State is a defendant in *Ceridian Corporation v. Franchise Tax Board*, a suit which challenges the validity of two sections of the California Tax Laws. The first relates to deduction from corporate taxes for dividends received from insurance companies to the extent the insurance companies have California activities. The second relates to corporate deduction of dividends to the extent the earnings of the dividend paying corporation have already been included in the measure of their California tax. On August 13, 1998, the court issued a judgment against the Franchise Tax Board on both issues. The Franchise Tax Board has appealed the judgment. Briefing is underway. If both sections of the California tax law are invalidated, and all dividends become deductible, in the future General Fund collections would be reduced annually in the \$200-\$250 million range for all taxpayers.

The State is involved in a lawsuit related to contamination at the Stringfellow toxic waste site. In *United States, People of the State of California v. J.B. Stringfellow, Jr., et al.*, the State is seeking recovery for past costs of cleanup of the site, a declaration that the defendants are jointly and severally liable for future costs, and an injunction ordering completion of the cleanup. However, the defendants have filed a counterclaim against the State for alleged negligent acts, resulting in significant findings of liability against the State as owner, operator, and generator of wastes taken to the site. The State has appealed the rulings. Present estimates of the cleanup range from \$400 million to \$600 million. Potential State liability falls within this same range. However, all or a portion of any judgment against the State could be satisfied by recoveries from the State's insurance carriers. The State has filed a suit against certain of these carriers and trial is currently set for January 16, 2001.

The State is a defendant in a coordinated action involving 3,000 plaintiffs seeking recovery for damages caused by the Yuba River flood of February 1986. The trial court found liability in inverse condemnation and awarded damages of \$500,000 to a sample of plaintiffs. The State's potential liability to the remaining plaintiffs ranges from \$800 million to \$1.5 billion.

In 1992, the State and plaintiffs filed appeals. In August 1999, the Court of Appeal issued a decision reversing the trial court's judgment against the State and remanding the case for retrial on the inverse condemnation cause of action. Plaintiffs have petitioned the California Supreme Court for review.

The State is a defendant in a statewide action, *Emily Q., et al. v. Belshe, et al.*, in which plaintiffs seek to compel a change in early screening procedures for children with mental health needs. A preliminary injunction was issued, requiring changes in the screening procedures. The Department of Health Services, in conjunction with the Department of Mental Health, is in the process of complying with the injunction. No hearing has been scheduled on the petition for permanent injunction. The Department of Mental Health estimates the annual cost to the State for implementation of a permanent injunction to be approximately \$13 million.

Plaintiffs in *County of San Bernardino v. Barlow Respiratory Hospital* and related actions seek mandamus relief requiring the State to retroactively increase out-patient Medi-Cal reimbursement rates. Plaintiffs have estimated the damages to be several hundred million dollars. The State is vigorously defending these cases, as well as related federal cases addressing the calculation of Medi-Cal reimbursement rates in the future.

The State is involved in two refund actions, *Cigarettes Cheaper!, et al. v. Board of Equalization, et al.* and *California Assn. Of Retail Tobacconists (CART), et al. v. Board of Equalization, et al.*, that challenge the constitutionality of Proposition 10, approved by the voters in 1998. Plaintiffs allege that Proposition 10, which increases the excise tax on tobacco products, violates 11 sections of the California Constitution and related provisions of law. Plaintiffs *Cigarettes Cheaper!* seek declaratory and injunctive relief and a refund of over \$4 million. The *CART* case filed by retail tobacconists in San Diego seeks a refund of \$5 million. The State is vigorously contesting these cases. If the statute is declared unconstitutional, exposure may include the entire \$750 million collected annually with interest.

The State is involved in two cases challenging the constitutionality of the interest offset provisions of the Revenue and Taxation Code. Plaintiffs in *F.W. Woolworth Co. and Kinney Shoe Corporation v. Franchise Tax Board* seek a refund of over \$15 million. The *Woolworth* case was tried in July 1995, and judgment was entered for the Franchise Tax Board. The judgment was upheld on appeal and the plaintiffs' petition for review in the California Supreme Court was denied. On June 7, 1999, plaintiffs filed a petition for writ of certiorari in the United States Supreme Court. The Franchise Tax Board filed its opposition to the petition for writ of certiorari on August 5, 1999.

Hunt-Wesson, Inc. v. Franchise Tax Board was tried in February, 1997 with judgment for taxpayer. The judgment was reversed on appeal and plaintiff's petition for review in the California Supreme Court was denied. On September 28, 1999, the United States Supreme Court granted the taxpayer's petition for writ of certiorari. The Franchise Tax Board estimates that if the interest-offset provisions are declared unconstitutional, the result would involve potential reduction of state revenues in the \$90 million range annually, with past year collection and interest exposure of \$500 million.

Guy F. Atkinson Company of California v. Franchise Tax Board is a corporation tax refund action involving the solar energy system tax credit provided for under the Revenue & Taxation Code. The case went to trial in May 1998 and the trial court entered judgment in favor of the Franchise Tax Board. The taxpayer has filed an appeal to the California Court of Appeal and briefing is due to be completed in October, 1999. The Franchise Tax Board estimates that the cost would be \$150 million annually if the plaintiff prevails. Allowing refunds for all open years would entail a refund of at least \$500 million.

Jordan, et al. v. Department of Motor Vehicles, et al. and *Josephs v. Zolin, et al.* challenge the validity of the Vehicle Smog Impact Fee, a \$300 fee which is collected by the Department of Motor Vehicles from vehicle registrants when a vehicle without a California new-vehicle certification is first registered in California. The *Jordan* plaintiffs contend that the fee violates the interstate commerce and equal protection clauses of the United States Constitution as well as Article XIX of the State Constitution. The *Josephs* case is a class action civil rights case brought against the current and former directors of the Department of Motor Vehicles in their individual capacities claiming the collection of the Vehicle Smog Impact Fee violates the interstate commerce, equal protection, and privileges and immunities clauses of the United States Constitution. The trial court gave a judgment for the plaintiffs in the *Jordan* case, and additionally ordered the state to file refund claims on behalf of all payers of the fees since 3 years prior to the filing of the complaint. The judgment has been appealed, briefing is completed, and the case has been argued. In *Josephs*, the Court of Appeal ruled that the taxpayer had an adequate remedy and thus the civil rights action could not proceed. A further appeal is possible. The exposure to the State if the trial court's decision in *Jordan* is upheld in full is \$350 million including interest. In addition, any revenue collected between the date of the trial court's decision and any final decision of a higher court is subject to refund.

Craig Brown, et al. v. Department of Health and Human Services, et al. is a Federal Mandate Proceeding. In fiscal years 1991-92 and 1992-93, the State used credits from three Public Employees Retirement System (PERS) accounts in place of General Fund employer pension contributions. The federal Department of Health and Human Services (DHHS) has determined that federally funded programs were overcharged in these fiscal years because they did not receive the pension credits the State programs received and that California owes the federal government \$120 million for overpayments plus an additional \$80 million in interest through mid 1999. The DHHS Grant Appeals Board upheld this determination. The present case is aimed at overturning the DHHS determination. On June 6, 1999, the court ruled against the State. The State has appealed to the Ninth Circuit. The estimated potential loss is over \$220 million which would be payable from the General Fund or, possibly, recovered by the federal government through offsets against current grant payments to the State.

PTI, Inc., et al. v. Philip Morris, et al. was filed by five distributors in the cigarette import-/re-entry business, seeking to overturn the tobacco Master Settlement Agreement (MSA) entered between 46 states and the tobacco industry in November, 1998. See "State Finances – Tobacco Litigation" above. The primary focus of the complaint is the provision of the MSA encouraging participating states to adopt a statute requiring nonparticipating manufacturers to either become participating manufacturers and share the financial obligations under the MSA or

pay money into an escrow account. Plaintiffs seek compensatory and punitive damages against the state and state officials and an order placing tobacco settlement funds into a trust to be administered by the court for the treatment of medical expenses of persons injured by tobacco products. A motion to dismiss the complaint is currently scheduled for hearing in February 2000. The potential fiscal impact of an adverse ruling is largely unknown, but could exceed the full amount of the settlement (estimated to be \$1 billion annually, of which 50% will go directly to the State's General Fund and the other 50% directly to the State's 58 counties and 4 largest cities).

STATE DEBT TABLES

The tables which follow provide information on outstanding State debt, authorized but unissued general obligation bonds and commercial paper notes, debt service requirements for State general obligation and lease-purchase bonds, and authorized and outstanding State revenue bonds. For purposes of these tables, "General Fund bonds," also known as "non-self liquidating bonds," are general obligation bonds expected to be paid from the General Fund without reimbursement from any other fund. Although the principal of general obligation commercial paper notes in the "non-self liquidating" category is legally payable from the General Fund, the State expects that principal of such commercial paper notes will be paid only from the issuance of new commercial paper notes or the issuance of long-term general obligation bonds to retire the commercial paper notes. Interest on "non-self liquidating" general obligation commercial paper notes is payable from the General Fund.

"Enterprise Fund bonds," also known as "self liquidating bonds," are general obligation bonds for which program revenues are expected to be sufficient to reimburse in full the General Fund for debt service payments, but any failure to make such a reimbursement does not affect the obligation of the State to pay principal and interest on the bonds from the General Fund.

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OUTSTANDING STATE DEBT
FISCAL YEARS 1994-95 THROUGH 1998-99
(Dollars in Thousands Except for Per Capita Information)

	<u>1994-95</u>	<u>1995-96</u>	<u>1996-97</u>	<u>1997-98</u>	<u>1998-99</u>
Outstanding Debt(a)					
General Obligation Bonds					
General Fund (Non-Self Liquidating).....	\$ 14,903,326	\$ 14,322,086	\$ 14,250,536	\$ 14,932,766	\$ 16,202,211
Enterprise Fund (Self Liquidating).....	4,171,775	3,934,630	3,699,060	3,906,950	3,674,020
Total.....	\$ 19,075,101	\$ 18,256,716	\$ 17,949,596	\$ 18,839,716	\$ 19,876,231
Lease-Purchase Debt.....	5,565,162	5,845,237	6,175,044	6,639,620	6,671,534
Total Outstanding General Obligation Bonds and Lease-Purchase Debt.....	\$ 24,640,263	\$ 24,101,953	\$ 24,124,640	\$ 25,479,336	\$ 26,547,765
Bond Sales During Fiscal Year					
Non-Self Liquidating General Obligation Bonds.	\$ 1,505,600	\$ 620,810	\$ 1,025,000	\$ 1,667,820	\$ 2,294,650
Self Liquidating General Obligation Bonds.....	\$ 386,930	\$ 0	\$ 0	\$ 447,535	\$ 80,000
Lease-Purchase Debt.....	\$ 598,817	\$ 779,575	\$ 1,257,630	\$ 1,245,190	\$ 456,410
Debt Service(b)					
Non-Self Liquidating General Obligation Bonds.	\$ 1,901,265	\$ 1,960,603	\$ 1,946,333	\$ 1,878,026	\$ 1,934,628
Lease-Purchase Debt.....	\$ 425,940	\$ 482,751	\$ 532,783	\$ 577,987	\$ 652,131
General Fund Receipts(b)	\$ 44,547,812	\$ 46,731,104	\$ 49,831,217	\$ 55,261,557	\$ 58,510,860
Non-Self Liquidating General Obligation Bonds Debt Service as a Percentage of General Fund Receipts.....	4.27%	4.20%	3.91%	3.40%	3.31%
Lease-Purchase Debt Service as a Percentage of General Fund Receipts.....	0.96%	1.03%	1.07%	1.05%	1.11%
Population(c)	31,790,000	32,063,000	32,383,000	32,957,000	33,494,000
Non-Self Liquidating General Obligation Bonds Outstanding Per Capita.....	\$ 468.81	\$ 446.69	\$ 440.06	\$ 453.10	\$ 483.73
Lease-Purchase Debt Outstanding Per Capita.....	\$ 175.06	\$ 182.30	\$ 190.69	\$ 201.46	\$ 199.19
Personal Income(d)	\$ 754,269,000	\$ 798,020,000	\$ 846,017,000	\$ 905,140,000	\$961,600,000
Non-Self Liquidating General Obligation Bonds Outstanding as Percentage of Personal Income..	1.98%	1.79%	1.68%	1.65%	1.68%
Lease-Purchase Debt Outstanding as Percentage of Personal Income.....	0.74%	0.73%	0.73%	0.73%	0.69%

(a) As of last day of fiscal year

(b) Calculated on a cash basis; debt service costs of bonds issued in any fiscal year largely appear in subsequent fiscal year.

(c) As of July 1, the beginning of the fiscal year.

(d) Calendar year in which fiscal year ends; 1998 & 1999 estimated.

SOURCES: Population and Personal Income: State of California, Department of Finance

Outstanding Debt, Bonds Sales During Fiscal Year and Debt Service: State of California, Office of the Treasurer.

General Fund Receipts: State of California, Office of the State Controller.

AUTHORIZED AND OUTSTANDING GENERAL OBLIGATION BONDS

As of October 1, 1999

(Thousands)

	<u>Voter Authorization</u>	<u>Bonds</u>	<u>CP Program</u>	<u>Unissued (b)</u>
	<u>Date</u>	<u>Amount</u>	<u>Outstanding</u>	<u>Authorized (a)</u>
GENERAL FUND BONDS (Non-Self Liquidating)				
California Earthquake Safety and Housing Rehabilitation Bond Act of 1988....	6/7/88	\$ 150,000	\$ 95,510	\$ n.a.
California Library Construction and Renovation Bond Act of 1988.....	11/8/88	75,000	52,705	1,225
California Park and Recreational Facilities Act of 1984.....	6/5/84	370,000	191,875	n.a.
California Parklands Act of 1980.....	11/4/80	285,000	60,005	n.a.
California Safe Drinking Water Bond Law of 1976.....	6/8/76	175,000	62,955	n.a.
California Safe Drinking Water Bond Law of 1984.....	11/6/84	75,000	39,000	n.a.
California Safe Drinking Water Bond Law of 1986.....	11/4/86	100,000	67,455	n.a.
California Safe Drinking Water Bond Law of 1988.....	11/8/88	75,000	43,190	16,265
California Wildlife, Coastal, and Park Land Conservation Act of 1988.....	6/7/88	776,000	518,560	n.a.
Class Size Reduction Public Education Facilities Bond Act of 1998 (Hi Ed)...	11/3/98	2,500,000	0	239,000
Class Size Reduction Public Education Facilities Bond Act of 1998 (K-12)...	11/3/98	6,700,000	688,000	2,262,000
Clean Air and Transportation Improvement Bond Act of 1990.....	6/5/90	1,990,000	1,085,505	283,925
Clean Water and Water Conservation Bond Law of 1978.....	6/6/78	375,000	77,940	n.a.
Clean Water and Water Reclamation Bond Law of 1988.....	11/8/88	65,000	49,970	0
Clean Water Bond Law of 1970.....	11/3/70	250,000	6,000	n.a.
Clean Water Bond Law of 1974.....	6/4/74	250,000	11,760	n.a.
Clean Water Bond Law of 1984.....	11/6/84	325,000	116,715	n.a.
Community Parklands Act of 1986.....	6/3/86	100,000	58,575	n.a.
County Correctional Facility Capital Expenditure and Youth Facility Bond Act of 1988.....	11/8/88	500,000	341,445	7,880
County Correctional Facility Capital Expenditure Bond Act of 1986.....	6/3/86	495,000	295,260	n.a.
County Jail Capital Expenditure Bond Act of 1981.....	11/2/82	280,000	108,525	n.a.
County Jail Capital Expenditure Bond Act of 1984.....	6/5/84	250,000	97,250	n.a.
Earthquake Safety and Public Buildings Rehabilitation Bond Act of 1990.....	6/5/90	300,000	80,810	70,000
Fish and Wildlife Habitat Enhancement Act of 1984.....	6/5/84	85,000	40,165	n.a.
Hazardous Substance Cleanup Bond Act of 1984.....	11/6/84	100,000	41,590	n.a.
Higher Education Facilities Bond Act of 1986.....	11/4/86	400,000	206,000	n.a.
Higher Education Facilities Bond Act of 1988.....	11/8/88	600,000	347,665	4,705
Higher Education Facilities Bond Act of June 1990.....	6/5/90	450,000	286,490	9,000
Higher Education Facilities Bond Act of June 1992.....	6/2/92	900,000	719,175	24,410
Housing and Homeless Bond Act of 1988.....	11/8/88	300,000	114,010	n.a.
Housing and Homeless Bond Act of 1990.....	6/5/90	150,000	80,480	n.a.
Lake Tahoe Acquisitions Bond Act.....	8/2/82	85,000	42,310	n.a.

AUTHORIZED AND OUTSTANDING GENERAL OBLIGATION BONDS (Continued)

	Voter Authorization		Outstanding	CP Program	
	Date	Amount		Authorized (a)	Unissued (b)
New Prison Construction Bond Act of 1981.....	6/8/82	\$ 495,000	130,750	\$ n.a.	\$ 0
New Prison Construction Bond Act of 1984.....	6/5/84	300,000	97,500	n.a.	0
New Prison Construction Bond Act of 1986.....	11/4/86	500,000	273,330	n.a.	1,500
New Prison Construction Bond Act of 1988.....	11/8/88	817,000	483,275	7,600	8,400
New Prison Construction Bond Act of 1990.....	6/5/90	450,000	282,780	20,100	0
Passenger Rail and Clean Air Bond Act of 1990.....	6/5/90	1,000,000	674,320	24,900	0
Public Education Facilities Bond Act of 1996.....	3/26/96	3,000,000	2,209,255	499,805	165,700
1988 School Facilities Bond Act.....	11/8/88	800,000	463,920	27,500	0
1990 School Facilities Bond Act.....	6/5/90	800,000	496,235	3,745	0
1992 School Facilities Bond Act.....	11/3/92	900,000	684,026	35,094	0
Safe, Clean Reliable Water Supply Act of 1996.....	11/5/96	995,000	148,370	134,000	707,000
Seismic Retrofit Bond Act of 1996.....	3/26/96	2,000,000	851,695	661,145	448,000
School Building and Earthquake Bond Act of 1974	11/5/74 (c)	40,000	35,995	n.a.	0
School Facilities Bond Act of 1988.....	6/7/88	800,000	443,405	n.a.	0
School Facilities Bond Act of 1990.....	11/6/90	800,000	508,020	19,500	0
School Facilities Bond Act of 1992.....	6/2/92	1,900,000	1,342,970	65,000	0
Senior Center Bond Act of 1984.....	11/6/84	50,000	17,250	n.a.	0
State Beach, Park, Recreational and Historical Facilities Bonds.....	6/4/74	250,000	2,850	n.a.	0
State School Building Lease-Purchase Bond Law of 1982.....	11/2/82	500,000	101,025	n.a.	0
State School Building Lease-Purchase Bond Law of 1984.....	11/6/84	450,000	192,500	n.a.	0
State School Building Lease-Purchase Bond Law of 1986.....	11/4/86	800,000	426,800	n.a.	0
State, Urban, and Coastal Park Bond Act of 1976.....	11/2/76	280,000	22,450	n.a.	0
Water Conservation and Water Quality Bond Law of 1986.....	6/3/86	150,000	76,230	n.a.	39,500
Water Conservation Bond Law of 1988.....	11/8/88	60,000	28,515	20,935	3,000
Total General Fund Bonds.....		\$ 37,668,000	\$ 16,020,361	\$ 4,437,734	\$ 7,906,580
ENTERPRISE FUND BONDS (Self Liquidating)					
California Water Resources Development Bond Act of 1959.....	11/8/60	\$ 1,750,000	\$ 971,180	\$ n.a.	\$ 167,600
State School Building Aid and Earthquake Reconstruction and Replacement Bond Law of 1974.....	11/5/74 (c)	110,000	2,500	n.a.	0
Veterans Bonds.....	(d)	5,610,000	2,636,235	14,000	301,500
Total Enterprise Fund Bonds.....		\$ 7,470,000	\$ 3,609,915	\$ 14,000	\$ 469,100
TOTAL GENERAL OBLIGATION BONDS.....		\$ 45,138,000	\$ 19,630,276	\$ 4,451,734	\$ 8,375,680

(a) Total commercial paper authorized to be issued by the respective Finance Committees. Of this total \$814,565,000 is outstanding as of October 1, 1999.

Pursuant to terms of the Finance Committee resolutions, no more than \$1.5 billion of commercial paper can be outstanding at any one time.

Bond acts marked "n.a." are not legally permitted to utilize commercial paper, or all bonds were issued before the commercial paper program began.

(b) Treats full commercial paper authorization as issued; see footnote (a).

(c) Pursuant to Prop 203, passed by the voters in the March 26, 1996 primary election, \$40 million in bonds unissued at that time became general fund supported, while all previously issued bonds will remain under "State School Building Aid Bonds" as self-liquidating Enterprise Bonds.

(d) Various dates.

SOURCE: State of California, Office of the Treasurer.

**SCHEDULE OF DEBT SERVICE REQUIREMENTS
FOR GENERAL FUND GENERAL OBLIGATION BONDS(a)
(Non-Self Liquidating)
As of October 1, 1999**

Fiscal Year Ending	Current Debt		
June 30	Interest	Principal (b)	Total
2000.....	\$545,458,333.82	\$500,745,000.00	\$1,046,203,333.82 (c)
2001.....	892,488,188.00	1,104,983,068.25	1,997,471,256.25
2002.....	818,083,787.57	1,148,955,000.00	1,967,038,787.57
2003.....	750,195,480.14	1,098,276,391.80	1,848,471,871.94
2004.....	681,540,337.95	1,024,330,000.00	1,705,870,337.95
2005.....	622,453,888.84	961,269,388.71	1,583,723,277.55
2006.....	561,270,168.75	897,915,000.00	1,459,185,168.75
2007.....	505,117,853.02	853,315,000.00	1,358,432,853.02
2008.....	455,511,252.94	836,313,078.31	1,291,824,331.25
2009.....	403,700,893.75	827,100,000.00	1,230,800,893.75
2010.....	352,985,782.50	758,000,000.00	1,110,985,782.50
2011.....	308,444,678.59	680,529,045.16	988,973,723.75
2012.....	264,036,492.55	537,935,000.00	801,971,492.55
2013.....	235,160,700.00	427,040,000.00	662,200,700.00
2014.....	214,614,179.64	351,600,000.00	566,214,179.64
2015.....	197,635,062.19	340,175,000.00	537,810,062.19
2016.....	180,413,443.49	337,890,000.00	518,303,443.49
2017.....	162,487,027.81	337,965,000.00	500,452,027.81
2018.....	145,359,027.48	337,245,000.00	482,604,027.48
2019.....	128,120,113.75	336,210,000.00	464,330,113.75
2020.....	111,045,520.00	332,510,000.00	443,555,520.00
2021.....	95,071,540.00	331,185,000.00	426,256,540.00
2022.....	78,859,817.50	314,915,000.00	393,774,817.50
2023.....	62,133,350.45	317,235,000.00	379,368,350.45
2024.....	47,345,579.34	247,495,000.00	294,840,579.34
2025.....	35,354,164.33	208,145,000.00	243,499,164.33
2026.....	25,132,796.09	170,365,000.00	195,497,796.09
2027.....	16,574,302.34	153,725,000.00	170,299,302.34
2028.....	9,380,497.34	136,225,000.00	145,605,497.34
2029.....	3,957,181.25	85,020,000.00	88,977,181.25
2030.....	676,000.00	25,750,000.00	26,426,000.00
Total	\$8,910,607,441.42	\$16,020,360,972.23	\$24,930,968,413.65

(a) Does not include commercial paper outstanding.

(b) Includes scheduled mandatory sinking fund payments as well as serial maturities.

(c) Total represents the remaining debt service requirements from November 1, 1999 through June 30, 2000.

SOURCE: State of California, Office of the Treasurer.

**SCHEDULE OF DEBT SERVICE REQUIREMENTS
FOR ENTERPRISE FUND GENERAL OBLIGATION BONDS(a)
(Self Liquidating)
As of October 1, 1999**

Fiscal Year Ending June 30	Current Debt		
	Interest	Principal (b)	Total
2000.....	\$149,798,482.70	\$68,715,000.00	\$218,513,482.70 (c)
2001.....	206,175,817.50	138,510,000.00	344,685,817.50
2002.....	195,727,982.50	141,975,000.00	337,702,982.50
2003.....	185,156,462.60	142,055,000.00	327,211,462.60
2004.....	174,218,995.00	165,320,000.00	339,538,995.00
2005.....	162,571,836.00	178,070,000.00	340,641,836.00
2006.....	150,539,333.50	161,785,000.00	312,324,333.50
2007.....	139,044,657.26	175,675,000.00	314,719,657.26
2008.....	126,950,918.55	173,735,000.00	300,685,918.55
2009.....	115,296,393.75	173,355,000.00	288,651,393.75
2010.....	104,122,261.55	168,325,000.00	272,447,261.55
2011.....	94,365,997.00	123,750,000.00	218,115,997.00
2012.....	86,988,773.50	162,050,000.00	249,038,773.50
2013.....	78,921,033.50	162,325,000.00	241,246,033.50
2014.....	71,817,020.45	128,455,000.00	200,272,020.45
2015.....	65,659,585.65	127,175,000.00	192,834,585.65
2016.....	59,127,864.50	132,480,000.00	191,607,864.50
2017.....	52,667,297.73	124,055,000.00	176,722,297.73
2018.....	46,686,645.34	103,540,000.00	150,226,645.34
2019.....	41,264,379.21	99,465,000.00	140,729,379.21
2020.....	36,788,306.80	64,610,000.00	101,398,306.80
2021.....	33,122,356.29	58,650,000.00	91,772,356.29
2022.....	29,722,011.14	55,055,000.00	84,777,011.14
2023.....	26,449,898.75	36,370,000.00	62,819,898.75
2024.....	24,354,632.50	38,540,000.00	62,894,632.50
2025.....	22,135,090.00	40,785,000.00	62,920,090.00
2026.....	19,778,907.50	67,745,000.00	87,523,907.50
2027.....	16,286,216.25	51,320,000.00	67,606,216.25
2028.....	13,321,595.00	12,010,000.00	25,331,595.00
2029.....	12,495,213.75	18,055,000.00	30,550,213.75
2030.....	11,632,567.50	13,325,000.00	24,957,567.50
2031.....	10,991,320.00	9,795,000.00	20,786,320.00
2032.....	10,426,040.00	10,365,000.00	20,791,840.00
2033.....	5,068,310.00	282,475,000.00	287,543,310.00
Total	\$2,579,675,003.27	\$3,609,915,000.00	\$6,189,590,003.27

(a) Does not include commercial paper outstanding.

(b) Includes scheduled mandatory sinking fund payments as well as serial maturities.

(c) Total represents the remaining debt service requirements from November 1, 1999 through June 30, 2000.

SOURCE: State of California, Office of the Treasurer.

**SCHEDULE OF DEBT SERVICE REQUIREMENTS
FOR LEASE-PURCHASE DEBT
As of October 1, 1999**

Fiscal Year Ending June 30	Current Debt		
	Interest	Principal (a)	Total
2000.....	\$ 271,854,083.43	\$ 190,980,000.00	\$ 462,834,083.43 (b)
2001.....	337,986,622.31	314,599,019.75	652,585,642.06
2002.....	323,318,414.51	294,675,773.02	617,994,187.53
2003.....	311,554,196.76	295,946,118.58	607,500,315.34
2004.....	296,093,162.54	303,636,386.24	599,729,548.78
2005.....	281,948,175.30	317,164,507.20	599,112,682.50
2006.....	263,223,234.68	335,727,554.60	598,950,789.28
2007.....	250,934,121.34	287,713,920.44	538,648,041.78
2008.....	233,199,977.04	294,491,787.98	527,691,765.02
2009.....	221,845,841.93	315,072,732.44	536,918,574.37
2010.....	199,824,471.09	302,106,633.76	501,931,104.85
2011.....	172,705,355.99	313,235,000.00	485,940,355.99
2012.....	155,993,528.04	294,855,000.00	450,848,528.04
2013.....	140,141,011.20	301,195,000.00	441,336,011.20
2014.....	124,085,424.73	301,750,000.00	425,835,424.73
2015.....	107,683,707.23	317,570,000.00	425,253,707.23
2016.....	90,680,741.78	296,190,000.00	386,870,741.78
2017.....	74,477,954.54	298,240,000.00	372,717,954.54
2018.....	58,734,243.47	309,680,000.00	368,414,243.47
2019.....	42,857,113.54	265,055,000.00	307,912,113.54
2020.....	29,067,354.98	231,630,000.00	260,697,354.98
2021.....	18,292,074.27	167,645,000.00	185,937,074.27
2022.....	9,449,946.23	141,345,000.00	150,794,946.23
2023.....	3,794,375.65	83,125,000.00	86,919,375.65
2024.....	271,065.63	2,515,000.00	2,786,065.63
2025.....	93,267.50	2,730,000.00	2,823,267.50
Total	\$ 4,020,109,465.71	\$ 6,578,874,434.01	\$ 10,598,983,899.72

(a) Includes scheduled mandatory sinking fund payments as well as serial maturities.

(b) Total represents the remaining debt service requirements from November 1, 1999 through June 30, 2000

SOURCE: State of California, Office of the Treasurer.

**STATE PUBLIC WORKS BOARD AND
OTHER LEASE-PURCHASE FINANCING
OUTSTANDING ISSUES
October 1, 1999**

<u>Name of Issue</u>	<u>Outstanding</u>
<u>GENERAL FUND SUPPORTED ISSUES:</u>	
State Public Works Board	
California Community Colleges	\$ 663,370,000
Department of Corrections *	2,677,616,141
Energy Efficiency Program (Various State Agencies) (a)	133,585,000
The Regents of The University of California * (b)	1,107,958,293
Trustees of The California State University.....	717,775,000
Various State Office Buildings.....	324,190,000
Total State Public Works Board Issues.....	\$ 5,624,494,434
 Total Other State Building Lease Purchase Issues (c)	 \$ 954,380,000
 Total General Fund Supported Issues.....	 \$ 6,578,874,434
<u>SPECIAL FUND SUPPORTED ISSUES:</u>	
East Bay State Building Authority Certificates of Participation (State of California Department of Transportation) *	\$ 84,177,399
San Bernardino Joint Powers Financing Authority (State of California Department of Transportation).....	62,220,000
San Francisco State Building Authority (State of California Department of General Services Lease) (d)	49,530,000
Total Special Fund Supported Issues.....	\$ 195,927,399
 TOTAL	 \$ 6,774,801,833

* Includes the initial value of capital appreciation bonds rather than the accreted value.

(a) This program is self-liquidating based on energy cost savings.

(b) The Regents' obligations to the State Public Works Board are payable from lawfully available funds of The Regents which are held in The Regents' treasury funds and are separate from the State General Fund. A portion of The Regents' annual budget is derived from General Fund appropriations.

(c) Includes \$196,615,000 Sacramento City Financing Authority Lease Revenue Bonds State of California - Cal EPA Building, 1998 Series A, which are supported by lease rentals from the California Environmental Protection Agency; these rental payments are subject to annual appropriation by the State Legislature.

(d) The sole tenant is the California Public Utilities Commission.

SOURCE: State of California, Office of the Treasurer.

**STATE AGENCY REVENUE BONDS
AND CONDUIT FINANCING
As of June 30, 1999**

<u>Issuing Agency</u>	<u>Outstanding^(a)</u>
<u>State Programs Financing:</u>	
California State University.....	\$ 449,893,000
California Transportation Commission.....	--
Department of Water Resources.....	2,504,785,000
The Regents of the University of California.....	2,817,545,000
Trade and Commerce Agency.....	--
<u>Housing Financing:</u>	
California Housing Finance Agency.....	6,054,124,133
Veterans Revenue Debenture.....	404,215,000
<u>Conduit Financing:</u>	
California Alternative Energy and Advanced Transportation Financing Authority.....	59,535,000
California Educational Facilities Authority.....	2,170,807,227
California Health Facilities Financing Authority.....	6,075,731,560
California Infrastructure and Economic Development Bank ^{(b) (c)}	387,783,908
California Passenger Rail Financing Commission.....	--
California Pollution Control Financing Authority	5,025,116,800
California School Finance Authority.....	205,000
California Student Loan Authority.....	55,260,000
California Urban Waterfront Area Restoration Financing Authority.....	3,005,000
TOTAL.....	<u><u>\$ 26,008,006,628</u></u>

^(a) Total Outstanding does not include defeased bonds and includes the accreted values for capital appreciation bonds.

^(b) Does not include \$6.0 billion of "rate reduction bonds" issued by special purpose trusts for the benefit of three investor-owned electric utility companies representing interests in certain electric rate surcharges.

^(c) California Economic Development Financing Authority merged with California Infrastructure and Economic Development Bank effective January 1, 1999.

STATEMENT of GENERAL FUND CASH RECEIPTS and DISBURSEMENTS

June 1999



KATHLEEN CONNELL
California State Controller



KATHLEEN CONNELL
Controller of the State of California

July 6, 1999

Users of the Statement of General Fund Cash Receipts and Disbursements:

The Statements of General Fund Cash Receipts and Disbursements for the period July 1, 1998, through June 30, 1999, are attached. These statements reflect the State of California's General Fund cash position, and detail expenditures and revenues on a cash basis in comparison to the 1999-00 May Revision and the 1998-99 Budget Act. These statements are prepared in compliance with Government Code Section 12461.1, as well as Item 0840-001-0001, Provision 10, of the 1998-99 Budget Act, using records compiled by the State Controller.

Attachment A compares actual receipts and disbursements to date for the 1998-99 fiscal year to cash flow estimates based on the 1999-00 May Revision. The May Revision cash flow reflects an expected increase of \$1.6 billion in receipts, and an expected increase of \$341.6 million in disbursements from the Budget Act estimates for the 1998-99 fiscal year. These cash flow estimates were predicated on projections and assumptions made by the Department of Finance in preparation of the May Revision.

Attachment B compares actual receipts and disbursements to date for the 1998-99 fiscal year to cash flow estimates prepared by the Department of Finance based upon the 1998-99 Budget Act. Prior year-to-date actual amounts are also displayed for comparative purposes.

These statements are available on the Internet at the State Controller's home page at <http://www.sco.ca.gov>, under the category "Statements of General Fund Cash Receipts and Disbursements."

Any questions concerning this report may be directed to Helen M. Shepherd, Chief Deputy State Controller, Finance, at (916) 445-2636.

Sincerely,

A handwritten signature in cursive script, reading "Kathleen Connell", is positioned below the word "Sincerely,".

KATHLEEN CONNELL
State Controller

KC:WGA:jmg

STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS
A Comparison of Actual to 1999-00 May Revision Estimates
(Amounts in thousands)
Attachment A

	July 1 through June 30				
	1999				1998
	Actual	May Revision Cash Flow Estimate as of May 24, 1999	Actual Over or (Under) Estimate		Actual
			Amount (a)	%	
GENERAL FUND BEGINNING CASH BALANCE	\$ 934,607	\$ 934,606	\$ 1	-----	\$ -----
Add Receipts:					
Revenues	58,287,784	58,822,345	(534,561)	(0.9)	54,485,140
Nonrevenues	223,076	(99,923)	322,999	-----	776,417
Total Receipts	58,510,860	58,722,422	(211,562)	(0.4)	55,261,557
Less Disbursements:					
State Operations	14,348,442	14,526,638	(178,196)	(1.2)	14,100,727
Local Assistance	41,869,788	43,929,377	(2,059,589)	(4.7)	38,480,452
Capital Outlay	243,231	368,292	(125,061)	(34.0)	52,949
Nongovernmental	2,136,070	1,347,832	788,238	58.5	502,435
Total Disbursements	58,597,531	60,172,139	(1,574,608)	(2.6)	53,136,563
Receipts Over / (Under) Disbursements	(86,671)	(1,449,717)	1,363,046	-----	2,124,994
Net Increase / (Decrease) in Temporary Loans	-----	515,111	(515,111)	(100.0)	(1,190,387)
GENERAL FUND ENDING CASH BALANCE	847,936	-----	847,936	-----	934,607
Special Fund for Economic Uncertainties (b)	1,260,722	739,889	520,833	70.4	74,646
TOTAL CASH	\$ 2,108,658	\$ 739,889	\$ 1,368,769	185.0	\$ 1,009,253
BORROWABLE RESOURCES					
Available Borrowable Resources	\$ 8,719,976	\$ 8,484,266	\$ 235,710	2.8	\$ 6,866,830
Outstanding Loans	-----	515,111	(515,111)	(100.0)	-----
Unused Borrowable Resources	\$ 8,719,976	\$ 7,969,155	\$ 750,821	9.4	\$ 6,866,830

General Note:

This report is based upon funded cash. Funded cash is cash reported to and recorded in the records of the State Controller's Office. Amounts reported as funded cash may differ from amounts in other reports to the extent there are timing differences in the recording of in-transit items.

Footnotes:

- (a) May not add to total due to rounding.
(b) Includes the Disaster Response-Emergency Operations Account within the Special Fund for Economic Uncertainties.
(c) Excludes State School Building Bonds.
(d) Negative balances are the result of repayments received that are greater than disbursements made.

SCHEDULE OF CASH RECEIPTS

(Amounts in thousands)

REVENUES	July 1 through June 30						
	Month of June		1999				1998
	1999	1998	Actual	May Revision Cash Flow Estimate as of May 24, 1999	Actual Over or (Under) Estimate		Actual
					Amount (a)	%	
Alcoholic Beverage Excise Tax	\$ 22,394	\$ 21,623	\$ 273,467	\$ 275,000	\$ (1,533)	(0.6)	\$ 270,528
Bank and Corporation Tax	1,001,992	1,181,648	5,459,193	5,705,000	(245,807)	(4.3)	5,587,667
Cigarette Tax	10,150	15,302	147,509	154,000	(6,491)	(4.2)	165,388
Horse Racing Fees	3,104	8,406	24,724	22,000	2,724	12.4	45,782
Inheritance, Gift and Estate Taxes	49,903	58,000	877,900	904,000	(26,100)	(2.9)	787,383
Insurance Companies Tax	276,466	260,658	1,263,787	1,252,000	11,787	0.9	1,225,783
Personal Income Tax	3,053,802	2,716,209	30,728,902	30,844,000	(115,098)	(0.4)	27,781,518
Retail Sales and Use Taxes	1,922,264	1,816,116	18,731,422	18,849,000	(117,578)	(0.6)	17,614,594
Pooled Money Investment Interest	45,814	41,171	304,842	310,000	(5,158)	(1.7)	262,015
Trial Court	(86)	1,861	3,256	3,345	(89)	(2.7)	190,586
Not Otherwise Classified	28,292	37,582	472,782	504,000	(31,218)	(6.2)	553,896
Total Revenues	6,414,095	6,158,576	58,287,784	58,822,345	(534,561)	(0.9)	54,485,140
NONREVENUES							
Transfers from Special Fund for Economic Uncertainties	2,552	4,063	5,495	2,943	2,552	86.7	317,424
Transfers from Other Funds	30,862	43,889	(93,731)	(282,563)	188,832	-----	206,529
Miscellaneous	28,978	20,783	311,312	179,697	131,615	73.2	252,464
Total Nonrevenues	62,392	68,735	223,076	(99,923)	322,999	-----	776,417
Total Receipts	\$ 6,476,487	\$ 6,227,311	\$ 58,510,860	\$ 58,722,422	\$ (211,562)	(0.4)	\$ 55,261,557

See notes on page A1.

SCHEDULE OF CASH DISBURSEMENTS

(Amounts in thousands)

STATE OPERATIONS	July 1 through June 30						
	Month of June		1999				1998
	1999	1998	Actual	May Revision Cash Flow Estimate as of May 24, 1999	Actual Over or (Under) Estimate		Actual
					Amount (a)	%	
Legislative/Judicial/Executive	\$ 39,804	\$ 35,272	\$ 836,216	\$ 833,924	\$ 2,292	0.3	\$ 787,975
State and Consumer Services	32,816	20,662	393,077	399,129	(6,052)	(1.5)	367,302
Business, Transportation and Housing	397	1,285	7,298	29,395	(22,097)	(75.2)	13,664
Trade and Commerce	1,550	3,020	31,384	36,143	(4,759)	(13.2)	32,067
Resources	59,279	13,069	578,160	582,831	(4,671)	(0.8)	481,811
CA Environmental Protection Agency	12,972	3,057	108,587	124,600	(16,013)	(12.9)	58,954
Health and Welfare:							
Health Services	3,240	(6,541)	215,321	202,206	13,115	6.5	150,225
Mental Health Hospitals	12,622	36,711	295,744	321,296	(25,552)	(8.0)	305,918
Other Health and Welfare	(1,950)	25,892	302,323	247,219	55,104	22.3	171,464
Education:							
University of California	71,512	97,457	2,492,755	2,518,340	(25,585)	(1.0)	2,182,550
State Universities and Colleges	187,116	153,389	2,023,826	2,124,467	(100,641)	(4.7)	1,897,276
Other Education	11,272	8,708	135,578	136,961	(1,383)	(1.0)	134,208
Corrections and Youth Authority	316,434	324,917	3,846,222	3,858,751	(12,529)	(0.3)	3,895,909
General Government	42,751	33,072	672,210	768,875	(96,665)	(12.6)	606,843
Public Employees Retirement System	(46,319)	(64,739)	388,370	395,584	(7,214)	(1.8)	1,026,445
Debt Service (c)	78,703	70,954	1,938,702	1,891,779	46,923	2.5	1,869,928
Interest on Loans	57,696	108,739	82,669	55,138	27,531	49.9	118,188
Total State Operations	879,895	864,924	14,348,442	14,526,638	(178,196)	(1.2)	14,100,727
LOCAL ASSISTANCE							
Public Schools - K-12	1,198,932	1,075,862	21,099,058	21,984,622	(885,564)	(4.0)	19,758,033
Community Colleges	198,884	156,257	2,195,988	2,186,950	9,038	0.4	1,979,563
Debt Service - State School Building Bonds	-----	(288)	-----	(26,352)	26,352	-----	-----
Contributions to State Teachers' Retirement System	-----	-----	292,931	292,931	-----	-----	954,174
Other Education	60,702	12,888	1,237,750	1,287,805	(50,055)	(3.9)	878,879
Corrections and Youth Authority	3,367	3,915	82,955	136,625	(53,670)	(39.3)	65,678
Dept. of Alcohol and Drug Program	8,104	8,667	76,901	94,484	(17,583)	(18.6)	96,766
Dept. of Health Services:							
Medical Assistance Program	574,109	503,253	7,261,829	7,438,164	(176,335)	(2.4)	6,897,351
Other Health Services	71,711	36,978	406,769	367,408	39,361	10.7	274,566
Dept. of Developmental Services	12,477	(41,635)	589,835	661,580	(71,745)	(10.8)	380,596
Dept. of Mental Health	11,607	(12,281)	304,926	321,069	(16,143)	(5.0)	286,945
Dept. of Social Services:							
SSI/SSP/IHSS	194,948	172,429	2,660,635	2,776,049	(115,414)	(4.2)	2,015,922
CalWORKs	39,447	32,843	2,647,470	2,832,074	(184,604)	(6.5)	2,057,660
Other Social Services	131,692	109,274	1,057,999	834,018	223,981	26.9	1,336,007
Tax Relief	1,717	6,682	450,929	1,020,938	(570,009)	(55.8)	454,022
School Facility Aid Program	-----	-----	29,315	26,218	3,097	11.8	35,468
Other Local Assistance	103,274	46,986	1,474,498	1,694,794	(220,296)	(13.0)	1,008,822
Total Local Assistance	2,610,971	2,111,830	41,869,788	43,929,377	(2,059,589)	(4.7)	38,480,452

See notes on page A1.

(Continued)

SCHEDULE OF CASH DISBURSEMENTS (Continued)

(Amounts in thousands)

	July 1 through June 30						
	Month of June		1999			1998	
	1999	1998	Actual	May Revision Cash Flow Estimate as of May 24, 1999	Actual Over or (Under) Estimate		Actual
					Amount (a)	%	
CAPITAL OUTLAY	8,956	7,483	243,231	368,292	(125,061)	(34.0)	52,949
NONGOVERNMENTAL (d)							
Transfer to Special Fund for Economic Uncertainties	-----	-----	1,189,226	1,189,226	-----	-----	112,000
Transfer to Other Funds	304,868	11,667	956,882	158,606	798,276	503.3	175,613
Transfer to Revolving Fund	(15,434)	(30,060)	36,576	-----	36,576	-----	13,925
Advance:							
Earthquake Loan Repayment	-----	-----	-----	-----	-----	-----	45,490
State-County Property Tax Administration Program	(47,160)	(45,420)	(2,673)	-----	(2,673)	-----	(47,615)
Social Welfare Federal Fund	68,000	157,935	(239,791)	-----	(239,791)	-----	129,751
Tax Relief and Refund Account	(44,700)	(31,500)	-----	-----	-----	-----	-----
Trial Court Trust Fund	57,000	110,000	77,000	-----	77,000	-----	110,000
Counties for Social Welfare	265,371	146,522	118,850	-----	118,850	-----	(36,729)
Total Nongovernmental	587,945	319,144	2,136,070	1,347,832	788,238	58.5	502,435
Total Disbursements	\$ 4,087,767	\$ 3,303,381	\$ 58,597,531	\$ 60,172,139	\$ (1,574,608)	(2.6)	\$ 53,136,563
TEMPORARY LOANS							
Special Fund for Economic Uncertainties	\$ -----	\$ -----	\$ -----	\$ 515,111	\$ (515,111)	(100.0)	\$ (281,170)
Other Internal Sources	-----	-----	-----	-----	-----	-----	(909,217)
Revenue Anticipation Notes	(1,700,000)	(3,000,000)	-----	-----	-----	-----	-----
Net Increase / (Decrease) Loans	\$ (1,700,000)	\$ (3,000,000)	\$ -----	\$ 515,111	\$ (515,111)	(100.0)	\$ (1,190,387)

See notes on page A1.

(Concluded)

COMPARATIVE STATEMENT OF REVENUES RECEIVED
All Governmental Cost Funds
(Amounts in thousands)

	July 1 through June 30			
	General Fund		Special Funds	
	1999	1998	1999	1998
MAJOR TAXES, LICENSES, AND INVESTMENT INCOME:				
Alcoholic Beverage Excise Taxes	\$ 273,467	\$ 270,528	\$ -----	\$ -----
Bank and Corporation Tax	5,459,193	5,587,667	6	4
Cigarette Tax	147,509	165,388	752,022	484,291
Estate Tax	877,267	785,387	-----	-----
Gift Tax	98	3	-----	-----
Horse Racing Fees	24,724	45,782	37,723	36,349
Inheritance Tax	535	1,993	-----	-----
Insurance Companies Tax	1,263,787	1,225,783	-----	-----
Motor Vehicle Fuel Tax:				
Gasoline Tax	-----	-----	2,603,893	2,485,241
Diesel & Liquid Petroleum Gas	-----	-----	428,185	388,381
Jet Fuel Tax	-----	-----	1,968	1,685
Vehicle License Fees	-----	-----	3,740,458	3,876,781
Motor Vehicle Registration and Other Fees	-----	-----	1,890,734	1,792,798
Personal Income Tax	30,728,902	27,781,518	3,454	2,889
Retail Sales and Use Taxes	18,731,422	17,614,594	3,952,835	3,687,266
Pooled Money Investment Interest	304,842	262,015	380	468
Trial Court Revenues	3,256	190,586	-----	-----
Total Major Taxes, Licenses, and Investment Income	57,815,002	53,931,244	13,411,658	12,756,153
NOT OTHERWISE CLASSIFIED:				
Alcoholic Beverage License Fee	2,902	4,452	32,189	29,436
Electrical Energy Tax	-----	-----	196,844	44,185
Private Rail Car Tax	6,354	6,184	-----	-----
Penalties on Traffic Violations	-----	-----	83,988	79,707
Health Care Receipts	13,156	9,968	-----	-----
Revenues from State Lands	9,760	13,898	4,249	26,919
Abandoned Property	174,099	189,115	-----	-----
Miscellaneous	266,511	330,279	3,486,335	3,260,024
Not Otherwise Classified	472,782	553,896	3,803,605	3,440,271
Total Revenues, All Governmental Cost Funds	\$ 58,287,784	\$ 54,485,140	\$ 17,215,263	\$ 16,196,424

See notes on page A1.

STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS
A Comparison of Actual to 1998-99 Budget Act Estimates
(Amounts in thousands)
Attachment B

July 1 through June 30					
	1999				1998
	Actual	Budget Act Cash Flow Estimate as of Sep. 2, 1998	Actual Over or (Under) Estimate		Actual
			Amount (a)	%	
GENERAL FUND BEGINNING CASH BALANCE	\$ 934,607	\$ 934,606	\$ 1	-----	\$ -----
Add Receipts:					
Revenues	58,287,784	56,915,000	1,372,784	2.4	54,485,140
Nonrevenues	223,076	178,340	44,736	25.1	776,417
Total Receipts	58,510,860	57,093,340	1,417,520	2.5	55,261,557
Less Disbursements:					
State Operations	14,348,442	14,408,852	(60,410)	(0.4)	14,100,727
Local Assistance	41,869,788	43,632,093	(1,762,305)	(4.0)	38,480,452
Capital Outlay	243,231	375,945	(132,714)	(35.3)	52,949
Nongovernmental	2,136,070	1,413,616	722,454	51.1	502,435
Total Disbursements	58,597,531	59,830,506	(1,232,975)	(2.1)	53,136,563
Receipts Over / (Under) Disbursements	(86,671)	(2,737,166)	2,650,495	-----	2,124,994
Net Increase / (Decrease) in Temporary Loans	-----	1,802,560	(1,802,560)	(100.0)	(1,190,387)
GENERAL FUND ENDING CASH BALANCE	847,936	-----	847,936	-----	934,607
Special Fund for Economic Uncertainties (b)	1,260,722	-----	1,260,722	-----	74,646
TOTAL CASH	\$ 2,108,658	\$ -----	\$ 2,108,658	-----	\$ 1,009,253
BORROWABLE RESOURCES					
Available Borrowable Resources	\$ 8,719,976	\$ 7,742,820	\$ 977,156	12.6	\$ 6,866,830
Outstanding Loans	-----	1,802,560	(1,802,560)	(100.0)	-----
Unused Borrowable Resources	\$ 8,719,976	\$ 5,940,260	\$ 2,779,716	46.8	\$ 6,866,830

General Note:

This report is based upon funded cash. Funded cash is cash reported to and recorded in the records of the State Controller's Office. Amounts reported as funded cash may differ from amounts in other reports to the extent there are timing differences in the recording of in-transit items.

Footnotes:

- (a) May not add to total due to rounding.
(b) Includes the Disaster Response-Emergency Operations Account within the Special Fund for Economic Uncertainties.
(c) Excludes State School Building Bonds.
(d) Negative balances are the result of repayments received that are greater than disbursements made.

SCHEDULE OF CASH RECEIPTS

(Amounts in thousands)

REVENUES	July 1 through June 30						
	Month of June		1999				1998
	1999	1998	Actual	Budget Act Cash Flow Estimate as of Sep. 2, 1998	Actual Over or (Under) Estimate		Actual
					Amount (a)	%	
Alcoholic Beverage Excise Tax	\$ 22,394	\$ 21,623	\$ 273,467	\$ 268,000	\$ 5,467	2.0	\$ 270,528
Bank and Corporation Tax	1,001,992	1,181,648	5,459,193	6,107,000	(647,807)	(10.6)	5,587,667
Cigarette Tax	10,150	15,302	147,509	165,000	(17,491)	(10.6)	165,388
Horse Racing Fees	3,104	8,406	24,724	21,000	3,724	17.7	45,782
Inheritance, Gift and Estate Taxes	49,903	58,000	877,900	784,000	93,900	12.0	787,383
Insurance Companies Tax	276,466	260,658	1,263,787	1,281,000	(17,213)	(1.3)	1,225,783
Personal Income Tax	3,053,802	2,716,209	30,728,902	28,763,000	1,965,902	6.8	27,781,518
Retail Sales and Use Taxes	1,922,264	1,816,116	18,731,422	18,739,000	(7,578)	-----	17,614,594
Pooled Money Investment Interest	45,814	41,171	304,842	284,000	20,842	7.3	262,015
Trial Court	(86)	1,861	3,256	-----	3,256	-----	190,586
Not Otherwise Classified	28,292	37,582	472,782	503,000	(30,218)	(6.0)	553,896
Total Revenues	6,414,095	6,158,576	58,287,784	56,915,000	1,372,784	2.4	54,485,140
NONREVENUES							
Transfers from Special Fund for Economic Uncertainties	2,552	4,063	5,495	112,000	(106,505)	(95.1)	317,424
Transfers from Other Funds	30,862	43,889	(93,731)	(120,566)	26,835	-----	206,529
Miscellaneous	28,978	20,783	311,312	186,906	124,406	66.6	252,464
Total Nonrevenues	62,392	68,735	223,076	178,340	44,736	25.1	776,417
Total Receipts	\$ 6,476,487	\$ 6,227,311	\$ 58,510,860	\$ 57,093,340	\$ 1,417,520	2.5	\$ 55,261,557

See notes on page A1.

SCHEDULE OF CASH DISBURSEMENTS

(Amounts in thousands)

	July 1 through June 30						
	Month of June		1999				1998
	1999	1998	Actual	Budget Act Cash Flow Estimate as of Sep. 2, 1998	Actual Over or (Under) Estimate		Actual
					Amount (a)	%	
STATE OPERATIONS							
Legislative/Judicial/Executive	\$ 39,804	\$ 35,272	\$ 836,216	\$ 861,935	\$ (25,719)	(3.0)	\$ 787,975
State and Consumer Services	32,816	20,662	393,077	410,601	(17,524)	(4.3)	367,307
Business, Transportation and Housing	397	1,285	7,298	26,952	(19,654)	(72.9)	13,664
Trade and Commerce	1,550	3,020	31,384	36,887	(5,503)	(14.9)	32,067
Resources	59,279	13,069	578,160	559,065	19,095	3.4	481,811
CA Environmental Protection Agency	12,972	3,057	108,587	149,018	(40,431)	(27.1)	58,954
Health and Welfare:							
Health Services	3,240	(6,541)	215,321	209,928	5,393	2.6	150,225
Mental Health Hospitals	12,622	36,711	295,744	334,064	(38,320)	(11.5)	305,918
Other Health and Welfare	(1,950)	25,892	302,323	246,549	55,774	22.6	171,464
Education:							
University of California	71,512	97,457	2,492,755	2,517,858	(25,103)	(1.0)	2,182,550
State Universities and Colleges	187,116	153,389	2,023,826	2,161,345	(137,519)	(6.4)	1,897,276
Other Education	11,272	8,708	135,578	133,968	1,610	1.2	134,208
Corrections and Youth Authority	316,434	324,917	3,846,222	3,815,073	31,149	0.8	3,895,909
General Government	42,751	33,072	672,210	492,914	179,296	36.4	606,843
Public Employees Retirement System	(46,319)	(64,739)	388,370	395,584	(7,214)	(1.8)	1,026,445
Debt Service (c)	78,703	70,954	1,938,702	1,942,111	(3,409)	(0.2)	1,869,928
Interest on Loans	57,696	108,739	82,669	115,000	(32,331)	(28.1)	118,188
Total State Operations	879,895	864,924	14,348,442	14,408,852	(60,410)	(0.4)	14,100,727
LOCAL ASSISTANCE							
Public Schools - K-12	1,198,932	1,075,862	21,099,058	22,110,834	(1,011,776)	(4.6)	19,758,033
Community Colleges	198,884	156,257	2,195,988	2,228,968	(32,980)	(1.5)	1,979,563
Debt Service - State School Building Bonds	-----	(288)	-----	(23,884)	23,884	-----	-----
Contributions to State Teachers' Retirement System	-----	-----	292,931	726,475	(433,544)	(59.7)	954,174
Other Education	60,702	12,888	1,237,750	1,266,460	(28,710)	(2.3)	878,879
Corrections and Youth Authority	3,367	3,915	82,955	108,137	(25,182)	(23.3)	65,678
Dept. of Alcohol and Drug Program	8,104	8,667	76,901	88,628	(11,727)	(13.2)	96,766
Dept. of Health Services:							
Medical Assistance Program	574,109	503,253	7,261,829	6,844,782	417,047	6.1	6,897,351
Other Health Services	71,711	36,978	406,769	346,181	60,588	17.5	274,566
Dept. of Developmental Services	12,477	(41,635)	589,835	614,944	(25,109)	(4.1)	380,596
Dept. of Mental Health	11,607	(12,281)	304,926	317,070	(12,144)	(3.8)	286,945
Dept. of Social Services:							
SSI/SSP/IHSS	194,948	172,429	2,660,635	2,260,701	399,934	17.7	2,015,922
CalWORKs	39,447	32,843	2,647,470	2,223,522	423,948	19.1	2,057,660
Other Social Services	131,692	109,274	1,057,999	1,984,828	(926,829)	(46.7)	1,336,007
Tax Relief	1,717	6,682	450,929	991,769	(540,840)	(54.5)	454,022
School Facility Aid Program	-----	-----	29,315	23,748	5,567	23.4	35,468
Other Local Assistance	103,274	46,986	1,474,498	1,518,930	(44,432)	(2.9)	1,008,822
Total Local Assistance	2,610,971	2,111,830	41,869,788	43,632,093	(1,762,305)	(4.0)	38,480,452

See notes on page A1.

(Continued)

SCHEDULE OF CASH DISBURSEMENTS (Continued)

(Amounts in thousands)

	July 1 through June 30						
	Month of June		1999			1998	
	1999	1998	Actual	Budget Act Cash Flow Estimate as of Sep. 2, 1998	Actual Over or (Under) Estimate		Actual
					Amount (a)	%	
CAPITAL OUTLAY	8,956	7,483	243,231	375,945	(132,714)	(35.3)	52,949
NONGOVERNMENTAL (d)							
Transfer to Special Fund for Economic Uncertainties	-----	-----	1,189,226	1,255,000	(65,774)	(5.2)	112,000
Transfer to Other Funds	304,868	11,667	956,882	158,616	798,266	503.3	175,613
Transfer to Revolving Fund	(15,434)	(30,060)	36,576	-----	36,576	-----	13,925
Advance:							
Earthquake Loan Repayment	-----	-----	-----	-----	-----	-----	45,490
State-County Property Tax Administration Program	(47,160)	(45,420)	(2,673)	-----	(2,673)	-----	(47,615)
Social Welfare Federal Fund	68,000	157,935	(239,791)	-----	(239,791)	-----	129,751
Tax Relief and Refund Account	(44,700)	(31,500)	-----	-----	-----	-----	-----
Trial Court Trust Fund	57,000	110,000	77,000	-----	77,000	-----	110,000
Counties for Social Welfare	265,371	146,522	118,850	-----	118,850	-----	(36,729)
Total Nongovernmental	587,945	319,144	2,136,070	1,413,616	722,454	51.1	502,435
Total Disbursements	\$ 4,087,767	\$ 3,303,381	\$ 58,597,531	\$ 59,830,506	\$ (1,232,975)	(2.1)	\$ 53,136,563
TEMPORARY LOANS							
Special Fund for Economic Uncertainties	\$ -----	\$ -----	\$ -----	\$ 1,255,000	\$ (1,255,000)	(100.0)	\$ (281,170)
Other Internal Sources	-----	-----	-----	547,560	(547,560)	(100.0)	(909,217)
Revenue Anticipation Notes	(1,700,000)	(3,000,000)	-----	-----	-----	-----	-----
Net Increase / (Decrease) Loans	\$ (1,700,000)	\$ (3,000,000)	\$ -----	\$ 1,802,560	\$ (1,802,560)	(100.0)	\$ (1,190,387)

See notes on page A1.

(Concluded)

COMPARATIVE STATEMENT OF REVENUES RECEIVED
All Governmental Cost Funds
(Amounts in thousands)

	July 1 through June 30			
	General Fund		Special Funds	
	1999	1998	1999	1998
MAJOR TAXES, LICENSES, AND INVESTMENT INCOME:				
Alcoholic Beverage Excise Taxes	\$ 273,467	\$ 270,528	\$ -----	\$ -----
Bank and Corporation Tax	5,459,193	5,587,667	6	4
Cigarette Tax	147,509	165,388	752,022	484,291
Estate Tax	877,267	785,387	-----	-----
Gift Tax	98	3	-----	-----
Horse Racing Fees	24,724	45,782	37,723	36,349
Inheritance Tax	535	1,993	-----	-----
Insurance Companies Tax	1,263,787	1,225,783	-----	-----
Motor Vehicle Fuel Tax:				
Gasoline Tax	-----	-----	2,603,893	2,485,241
Diesel & Liquid Petroleum Gas	-----	-----	428,185	388,381
Jet Fuel Tax	-----	-----	1,968	1,685
Vehicle License Fees	-----	-----	3,740,458	3,876,781
Motor Vehicle Registration and Other Fees	-----	-----	1,890,734	1,792,798
Personal Income Tax	30,728,902	27,781,518	3,454	2,889
Retail Sales and Use Taxes	18,731,422	17,614,594	3,952,835	3,687,266
Pooled Money Investment Interest	304,842	262,015	380	468
Trial Court Revenues	3,256	190,586	-----	-----
Total Major Taxes, Licenses, and Investment Income	57,815,002	53,931,244	13,411,658	12,756,153
NOT OTHERWISE CLASSIFIED:				
Alcoholic Beverage License Fee	2,902	4,452	32,189	29,436
Electrical Energy Tax	-----	-----	196,844	44,185
Private Rail Car Tax	6,354	6,184	-----	-----
Penalties on Traffic Violations	-----	-----	83,988	79,707
Health Care Receipts	13,156	9,968	-----	-----
Revenues from State Lands	9,760	13,898	4,249	26,919
Abandoned Property	174,099	189,115	-----	-----
Miscellaneous	266,511	330,279	3,486,335	3,260,024
Not Otherwise Classified	472,782	553,896	3,803,605	3,440,271
Total Revenues, All Governmental Cost Funds	\$ 58,287,784	\$ 54,485,140	\$ 17,215,263	\$ 16,196,424

See notes on page A1.

APPENDIX B

THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND

This Appendix B includes information about the Department, its Program, the 1943 Fund (including audited financial statements), and the Department's allocation of receipts from Contracts of Purchase, including Excess Revenues.

THE DEPARTMENT

General

In 1921, the California Legislature created the Veterans' Welfare Board and the Program. The Department of Veterans Affairs became the successor to the Veterans' Welfare Board under the Farm and Home Purchase Act of 1943. The Department is a subdivision of the State and constitutes a public corporation. One of the Department's basic objectives is to afford to eligible veterans the opportunity of acquiring homes with long-term low-interest financing provided under the Program.

The California Veterans Board ("Board") determines the policies for all operations of the Department. The Board is composed of seven members: the Secretary of Veterans Affairs and six public members appointed by the Governor of the State for respective terms of four years. All of the members of the Board must be veterans, and membership is subject to confirmation by the State Senate. One of these members must be retired from the active or reserve forces of the United States military service.

There are four principal divisions within the Department: the Division of Veterans Services, the Division of Administration, the Veterans' Home Division and the Division of Farm and Home Purchases. The Program is administered by the Division of Farm and Home Purchases with support from the Division of Administration and other Department support units. See "THE PROGRAM."

Administration

In addition to its headquarters in Sacramento, the Division of Farm and Home Purchases maintains field offices located throughout the State. These local offices, in addition to providing information to all veterans concerning the Program, are responsible for Contract of Purchase originations and the initial collection and evaluation of data regarding applicants for the Program and the property to be acquired under the Program. This includes an examination as to the qualification of veterans to participate in the Program, a credit analysis, an appraisal of properties and the initial processing of the veteran's application for a Contract of Purchase.

Final processing and servicing of the Contracts of Purchase are performed by the Department at its headquarters and entail Contract of Purchase accounting, insurance and property damage claims adjustment and services, Contract of Purchase alterations and contract performance services. The Department allows Contracts of Purchase origination by mortgage

brokers and has engaged the temporary services of an outside loan servicing company, Leader Mortgage Company ("Leader"), to service Contracts of Purchase originated between April 1, 1998 and July 1, 1999. Effective July 1, 1999 the Department began utilizing its new Integrated Loan Processing and Financial Information System for origination and servicing of all new Contracts of Purchase. General administration of the Program, including fiscal, legal, personnel and other administrative functions, is also performed at the Department's headquarters. As of June 30, 1999 the Department's Farm and Home Purchases Division had a staff of approximately 115 persons.

The Secretary and other staff personnel of the Department principally responsible for the administration of the Program are listed below. The Secretary is appointed by the Governor of the State, serves at the pleasure of the Governor, and must be a veteran. There is currently a vacancy in the office of Deputy Director, Administration Division.

Tomas Alvarado
Secretary of Veterans Affairs since May 1999

Secretary Alvarado brings to his position a career-long commitment to veterans issues. Mr. Alvarado has an extensive background in public policy development at every level of government. For the past quarter century he has worked in county government and with the State Legislature and the United States Senate as a member of several public policy staffs. In addition to significant local and legislative experience, Mr. Alvarado has a strong background within the Executive Branch of State government. From January 1999 to May 1999 Mr. Alvarado served as Undersecretary for the Department. In addition from 1991 to 1995 he served as Deputy Director of Veterans Affairs for then-Governor Wilson. In this position, Mr. Alvarado had as one of his responsibilities oversight of the Program. Mr. Alvarado is a decorated United States Marine veteran of the Vietnam conflict and is a graduate of San Jose State University.

Gerald Rucker
Senior Assistant to the Secretary since May 1999

Mr. Rucker brings a 28-year history of California State Management to the Department. Recent experience includes eight years as Chief of Veterans Services Division and State Service Officer for the Department. Prior to joining the Department management team in 1991, he held a variety of management posts with the departments of Social Services and Rehabilitation. These positions included Personnel Management, Loma Prieta Earthquake Disaster Recovery Team manager as well as assignments with fiscal information technology and systems development responsibility. Mr. Rucker is a service-connected disabled veteran who served with the 1st Cavalry Division in Vietnam, including combat action during the TET Offensive of 1968.

Bruce Thiesen
Deputy Secretary for Operations since January 1999

Deputy Secretary Thiesen is a Vietnam-era Army veteran with a long history as a veterans activist. Mr. Thiesen is an independent agribusinessman with more than 30 years of broad experience in farm management, farm labor acquisition and benefits administration. Mr.

Thiesen served as National Commander of the American Legion in 1993-1994 and from 1995 through 1998 he was appointed by the Secretary of the United States Department of Veterans Affairs as a member of the Veterans Advisory Committee on Rehabilitation. In addition to his work on behalf of veterans, Mr. Thiesen is involved in a number of other community and philanthropic efforts.

Sheryl A. Schmidt
Deputy Secretary since November 1996

After leaving the accounting firm of Touche Ross (Deloitte & Touche) in 1987, Deputy Secretary Schmidt began her state career at the State Controller's Office as a Certified Public Accountant (CPA). In 1995, she accepted the newly created position of Chief of Audits at the Department and developed the Internal Audit Division. In 1996, the Governor of California appointed United States Air Force Veteran Sheryl Schmidt as the Deputy Secretary of Women Veterans Affairs. Ms. Schmidt holds a Bachelor's degree in management from St. Leo's College in Florida, a Master's of Business Administration (MBA) from California State University Sacramento, and a CPA license from the California State Board of Accountancy.

John M. Hanretty
Acting Deputy Director, Administration Division since September 1999

Mr. Hanretty is a United States Air Force, Vietnam-era veteran who graduated from California State University, Sacramento in 1975 with a degree in Government. After graduation, he worked for eight years in the California Department of Health Services regulating Prepaid Health Plans for Medicaid clients. He then spent twelve years in management positions with private health maintenance organizations in Arizona and California rising to the level of Chief Executive Officer. His responsibilities included sales, medical management, provider staffing, member services, contracting, financial accounting and budgeting. He returned to State government service in 1994 as a Budget manager. He has served as the Budget Officer for the Department for the past year. He has continuously served on community non-profit boards of directors during his professional career.

George Flores
Chief, Farm and Home Purchases Division since May 1999

Mr. Flores has been with the Department for 22 years. He has served as Manager of the Title and Escrow Unit Headquarters Operation Manager, Southern Regional Manager and the Assistant Division Chief. He is a United States Army veteran who graduated from California State University in 1973 with a Bachelors of Science degree in Business Administration and attended the McGeorge School, University of the Pacific.

Kandis L. Mendonsa
Chief, Bond Finance Division since May 1998

Ms. Mendonsa brings to her current position more than a quarter century of service in California state government. For most of that time, she has worked exclusively in the area of financial management. Prior to joining the Department in 1998, Ms. Mendonsa was employed

for 10 years by the Department of Social Services and for 12 years at the State Department of Corrections. While at Corrections, among Ms. Mendonsa's responsibilities was the management of a \$4 billion tax exempt bond program for the construction of youth and adult correction facilities.

Arnulfo Hernandez, Jr.
Chief Counsel since June 1999

Mr. Hernandez is a 18-year career employee of the Department. Hired as an entry level attorney, he became the Department's senior trial attorney and was appointed the Chief Counsel of the Department in June 1999. He served as Acting Chief Counsel between March and June 1999. Mr. Hernandez has a Bachelor's Degree in psychology from California State University, Los Angeles and a J.D. from University of the Pacific, McGeorge School of Law, Sacramento and is admitted to practice law in California. Mr. Hernandez is a U.S. Navy veteran, having served his country during the Vietnam war and was honorably discharged in 1971 with a V.A.-rated, service-connected disability.

Year 2000 Issues

Many existing computer programs used by the Department, other parts of State government, its third-party vendors, and DTC, may have used only two (2) digits to identify a year in the date field and, if not remediated, such systems could fail or create erroneous results beyond the year 1999. The Department has issued a Year 2000 Compliance Policy and is taking steps intended to ensure that its automated processes operate properly on and after January 1, 2000. In particular, the Department has undertaken, and continues to pursue, year 2000 compliance of all automated processes related to the Program.

General Department Operations. In its daily operations, the Department uses computer systems of other State departments for Statewide administrative functions, computer applications developed by outside vendors for the Department, and computer software which is widely available commercially. The State is addressing year 2000 compliance issues with respect to the Statewide administrative functions which the Department utilizes. To the extent that a manufacturer of any of the widely available commercial software packages used by the Department in its daily operations does not make satisfactory representations regarding year 2000 compliance issues, the Department intends to replace such software packages with new software packages with respect to which such representations have been made or which have demonstrated year 2000 compliance.

The Program. The Department has required that all private contractors, consultants, and vendors who provide services or support functions to the Program, such as loan servicing and insurance, provide the Department either with assurance that they are year 2000 compliant, or with their plans to become year 2000 compliant and their time frames for achieving such compliance. The Department has received such assurance and plans from all such parties. Any failure by some or all of these parties to become year 2000 compliant may have a material negative impact on the Department's operations or financial status.

In 1997, the Department initiated a Request for Proposal ("RFP") for a fully Integrated Loan Processing and Financial Information System, which is the mechanism used by the Department to manage its portfolio of Contracts of Purchase. The system selected is utilized by several other state housing finance agencies throughout the country. The system developer demonstrated to the Department during the RFP process that the system is year 2000 compliant. The Department implemented the new system on July 1, 1999 for most of its portfolio.

Program income is generated from two principal sources: principal and interest payments on Contracts of Purchase and earnings on investments. Payments from these sources are used to pay Department expenses, debt service on the Department's Revenue Bonds, and payment to or reimbursement of the State General Fund for debt service on Veterans G.O. Bonds. While some of the computer-assisted monitoring relied upon by the Department could possibly be done manually in case of a system failure, the Department has not identified an effective manual substitution for computer-assisted monitoring of its portfolio of Contracts of Purchase.

The Treasurer is responsible for transmitting principal and interest payments on Veterans G.O. Bonds and Revenue Bonds to the registered owners thereof. DTC is the registered owner of some of the Veterans G.O. Bonds and Revenue Bonds, and payments of principal and interest on Veterans G.O. Bonds and Revenue Bonds is payable by the Treasurer to DTC, and by DTC to its Participants in those cases. Therefore, timely payment and receipt of principal and purchase price of and interest on the Veterans G.O. Bonds and Revenue Bonds after January 2000 are dependent on the successful functioning of the payment systems of both the Treasurer and DTC. The Treasurer has reported that, as of December 31, 1998, its systems for bond payments were fully year 2000 compliant. SEE APPENDIX A—"THE STATE OF CALIFORNIA—OVERVIEW OF STATE GOVERNMENT—Year 2000—Related Information Technology." See APPENDIX C—"BOOK-ENTRY SYSTEM—DTC's Year 2000 Efforts" for information provided by DTC regarding its year 2000 compliance efforts.

The Department has not independently reviewed the assurances of other parts of State government, the developers of the Department's computer systems (other than its Integrated Loan Processing and Financial Information System), DTC and the Treasurer, and will not independently review the assurances made by its private contractors, consultants and vendors (other than the developer of its Integrated Loan Processing and Financial Information System). The State Controller's Office has reported that it had completed the necessary year 2000 remediation projects for the State fiscal and accounting systems by December 31, 1998. The Department, other parts of State government, the developers of its computer systems, the developers of widely available commercial software packages used by the Department, and the critical vendors may each subsequently discover areas of non-compliance.

The Department is not presently aware of any costs to achieve year 2000 compliance that will have a material negative impact on the Program or the Department's operations or financial status; however, the Department can give no assurance that any subsequently discovered non-compliance will not have such material negative impact.

Failure by one or more of the Department, other parts of State government, the developers of the Department's computer systems, DTC, the developers of the widely available commercial software packages used by the Department, and the critical vendors to be in year

2000 compliance could have a materially adverse effect on the programmatic and financial functionings of the Department.

Veterans' Homes Operations. In the Department's operations of the Department's Veterans' Homes, the Veterans' Division uses computer systems and software and electronic systems with embedded microprocessor chips which, unless remediated, may not function properly after the year 1999.

In September 1999, the State's Department of Information Technology ("DOIT") determined that there remained significant risk of failure by the Department to confirm Year 2000 compliance of certain "mission critical" systems. However, these systems, which principally consist of medical devices and related systems at the Veterans' Homes, relate solely to the operations of these facilities and do not in any way affect the Program, the 1943 Fund or the revenues derived therefrom.

THE PROGRAM

General

The Department began making low interest rate farm and home financing available to veterans after World War I, following the enactment by the California Legislature (the "Legislature") of the Veterans Farm and Home Purchase Act of 1921. In 1943, the Legislature enacted the Veterans Farm and Home Purchase Act of 1943 ("1943 Act") which modified the Program to meet new needs of veterans. The 1943 Act was superseded by the Veterans Farm and Home Purchase Act of 1974 ("1974 Act") which again modified the Program. The 1943 Act established the 1943 Fund in the State Treasury, which is the principal fund utilized by the Program.

Since its inception, the Program has assisted over 407,000 veterans to purchase farms and homes throughout the State through long-term housing and farm loans. The sales of revenue bonds and Veterans G.O. Bonds, combined with surplus revenues from borrowers under the Program not needed at any given time to meet the then-current bond retirement schedules and operating costs, have financed the purchase of farms and homes since Program inception. As of June 30, 1999 there were 32,243 Contracts of Purchase outstanding with a remaining principal balance of \$2,066,889,409. For the period covering July 1, 1999 through September 30, 1999, the Department funded Contracts of Purchase in the amount of approximately \$109,671,000. As of September 30, 1999, the Department has approximately 700 pending applications for Contracts of Purchase in the approximate total principal amount of \$113,426,000. See Exhibit 2 to this APPENDIX B—"Certain Department Financial Information and Operating Data—Contracts of Purchase—Existing Contracts of Purchase" and "—Amounts Expected to be Available to Finance Contracts of Purchase and Related Investments" for information regarding existing Contracts of Purchase and moneys available to finance additional Contracts of Purchase.

The description of the Program under this heading is a description of the Program as it currently exists under the Veterans Code and the Department's implementation thereof, including recent programmatic changes. The Veterans Code and the Department's implementation thereof are subject to change. The Program is also subject to the Federal Tax Code, as noted below.

Qualifying Veteran Status

Veterans Code. A veteran must meet qualifications established under State law in the Veterans Code in order to participate in the Program. The qualifications specified in the Veterans Code are subject to change by the Legislature. The Veterans Code currently requires, generally, that a veteran must have served at least ninety days on active duty in the Armed Forces of the United States, unless sooner discharged because of a service-connected disability, or as a member of the National Guard or reserves called to active duty by Presidential order, and must have received an honorable discharge or been released from active duty under honorable conditions. The Veterans Code (including amendments effective January 1, 1998) allows the Department to finance Contracts of Purchase for:

(a) veterans who have served during a period which includes service in one of the following periods:

(i) April 6, 1917 through November 11, 1918; December 7, 1941 through December 31, 1946; or June 27, 1950 through January 31, 1955 (such veterans are referred to as "Earlier War Veterans");

(ii) February 28, 1961 through August 4, 1964 if the veteran served in the Republic of Vietnam during that period ("Early Vietnam Veterans"); or August 5, 1964 through May 7, 1975 (all veterans referred to in this clause (ii) are "Vietnam Era Veterans"); or

(iii) on or after August 2, 1990, through a date as yet to be determined by the President of the United States; at any time in Somalia, or in direct support of the troops in Somalia, during Operation Restore Hope; or at any time in an expedition or campaign for which a medal was authorized by the United States Government such as the Armed Forces Expeditionary and Vietnam Service Medals (such veterans are referred to as "Recent War Veterans"); and

(b) any person who qualifies under the Federal Tax Code for financing from revenue bonds or unrestricted funds of the Department and who served in the active military, naval, or air service for a period of not less than 90 consecutive days and who received an honorable discharge or was released from active duty under honorable conditions (such veterans are referred to as "Peacetime Veterans").

The amendments to the Veterans Code effective January 1, 1998 added Early Vietnam Veterans and Peacetime Veterans as veterans eligible to receive Contracts of Purchase. The Department expects these amendments to significantly increase the universe of potential contract holders, and to increase demand for Contracts of Purchase.

Federal Tax Code. In order to determine which Department moneys can be used to finance Contracts of Purchase, the Department must also take into account the requirements of federal law set forth in the Federal Tax Code, which limits the universe of veterans eligible to receive Contracts of Purchase financed from certain sources. Applying the current Federal Tax Code separates the Department's lendable moneys into three classes:

(a) "Unrestricted Moneys" (derived from certain moneys in the 1943 Fund and certain proceeds of pre-Ullman revenue bonds and veterans general obligation bonds, including certain future issues of taxable bonds, if any), which can finance Contracts of Purchase for those veterans who qualify under the applicable provisions of the Veterans Code (there are no loan eligibility requirements imposed by the Federal Tax Code with respect to Contracts of Purchase financed by Unrestricted Moneys; these are requirements principally limiting the family income of applicants and the property purchase price, and, subject to certain exceptions, requiring that the veteran not have had a present ownership interest in his principal residence in the three years prior to obtaining such financing ("QMB Loan Eligibility Requirements")). The Department has implemented a policy (which is subject to change) to make such moneys available for Earlier War Veterans, Vietnam Era Veterans, and Recent War Veterans. ("Pre-Ullman" refers to the period prior to enactment of Federal Tax Code restrictions on the use of proceeds of tax-exempt bonds to finance mortgage loans.);

(b) "Qualified Veterans Mortgage Bond Proceeds" (derived exclusively from proceeds of Veterans G.O. Bonds) which can finance Contracts of Purchase for any veteran who (i) qualifies under the Veterans Code, (ii) served on active duty prior to January 1, 1977, and (iii) was released from active duty fewer than 30 years before receiving such financing. The last date of veteran eligibility under clause (iii) is December 31, 2036 for a veteran with 30 years of continuous service after December 31, 1976. (The QMB Loan Eligibility Requirements do not apply to Contracts of Purchase financed by such moneys.) These proceeds can finance Contracts of Purchase for Earlier War Veterans and Vietnam Era Veterans; and

(c) "Qualified Mortgage Bond Proceeds" (which are principally derived from Revenue Bond proceeds), can finance Contracts of Purchase for any veteran who (i) qualifies under the Veterans Code, and (ii) satisfies the QMB Loan Eligibility Requirements. These proceeds can finance Contracts of Purchase for Earlier War Veterans, Vietnam Era Veterans, Recent War Veterans, and Peacetime Veterans.

Allocation of Lendable Moneys

For those veterans seeking financing who would qualify for Contracts of Purchase from two or more of the above-described financing sources, the Department will select the source of funds to use in its sole discretion. The Department's goal is to maximize the availability of Program benefits. The Board has approved a policy (which is subject to change) to make Qualified Mortgage Bond Proceeds derived from Revenue Bonds the only financing source for Contracts of Purchase for veterans who did not serve during "wartime" (as defined in the Veterans Code).

Administration of the Farm and Home Purchase Program

The Department finances new and existing single-family homes, farms and mobile homes located in the State by acquiring the property selected by a veteran under a Contract of Purchase. The Department also finances home improvements with respect to properties covered by existing Contracts of Purchase, subject to applicable restrictions of the Federal Tax Code. A Contract of Purchase creates an installment land contract between the Department and the veteran which is analogous to a loan from the Department to the veteran. The amount which the Department finances is reflected in the Contract of Purchase as the "purchase price."

At present under the Veterans Code, the maximum purchase price to the Department of an existing home or the sum to be expended by the Department pursuant to a Contract of Purchase for a home to be constructed is \$250,000 and for farms is \$300,000 (except that the limitation with respect to certain mobile homes in mobile home parks is \$70,000 and except that the maximum purchase price for any home may be increased by an additional \$5,000 for certain purposes). The Legislature has periodically made changes in the maximum amount that may be financed under a Contract of Purchase. The Federal Tax Code imposes maximum purchase prices on properties which are the subject of Contracts of Purchase financed by Qualified Mortgage Bond Proceeds, which maximums are adjusted periodically. (No Federal Tax Code purchase price limits apply to Contracts of Purchase financed from Unrestricted Moneys or Qualified Veterans Mortgage Bond Proceeds.) These Federal Tax Code requirements vary depending upon where the property is located, if it is in a targeted or non-targeted area, and whether it is a new or existing home. These Federal Tax Code limits currently range from \$88,266 to \$313,512. The maximum purchase price under the Program is, therefore, the Veterans Code maximum amount or, if the Contract of Purchase is being financed by Qualified Mortgage Bond Proceeds, the lesser of the Veterans Code maximum amount or the maximum amount under applicable provisions of the Federal Tax Code.

Although the Veterans Code does not impose maximum income limits, the Federal Tax Code imposes maximum income limits applicable only to veterans obtaining Contracts of Purchase financed by Qualified Mortgage Bond Proceeds. The income limits vary by statistical area and family size. No maximum income limits apply to veterans obtaining Contracts of Purchase financed by Unrestricted Moneys or Qualified Veterans Mortgage Bond Proceeds.

Under amendments to the Veterans Code effective January 1, 1998, any veteran who qualifies under the Veterans Code and the Federal Tax Code may be granted a subsequent Contract of Purchase so long as any previous Contract of Purchase has been paid in full or the veteran lost his interest in the previous Contract of Purchase through divorce or dissolution of marriage.

Contracts of Purchase

General. Pursuant to the Program, the Department and the veteran enter into a Contract of Purchase for a farm, home or mobile home. Under a Contract of Purchase, the veteran has the benefits of ownership as the equitable owner, but title to the property and improvements is held by the Department as the legal owner until the final principal payment is made. Property sold under a Contract of Purchase may not be transferred, assigned, encumbered, leased, let or

sublet without the written consent of the Department. Any permitted encumbrance must be junior or secondary to the Department's interest in the property.

In the past, Contracts of Purchase were not insured or guaranteed by the Federal Housing Administration, the United States Department of Veterans Affairs (the "USDVA"), Rural Development (formerly, Farmers' Home Administration), or any private primary mortgage insurer. Now that the Department has been approved by the USDVA as an originator of loans eligible to receive a guaranty from the USDVA, USDVA guaranties are expected to be obtained for most new high loan-to-value ("LTV") Contracts of Purchase. In addition to the USDVA guaranty, the Department has secured primary mortgage insurance for a pool of certain Contracts of Purchase with LTV ratios above 80%, but not to exceed 97%, from Radian Guaranty Inc. ("Radian"), formerly Commonwealth Mortgage Assurance Company (CMAC). This insurance retroactively covers, effective February 1, 1998, aggregate losses incurred above a 2% deductible. Veterans and properties which are not USDVA eligible and which do not meet Radian eligibility criteria are expected to continue to be the subject of the Department's Self Insurance Mortgage Loss Set-Aside account (described below).

The terms of the Contracts of Purchase are substantially identical regardless of whether they are funded by Unrestricted Moneys, Qualified Veterans Mortgage Bond Proceeds or Qualified Mortgage Bond Proceeds, except for Federal Tax Code-mandated differences in Contracts of Purchase financed with Qualified Mortgage Bond Proceeds. Two ways in which such Contracts of Purchase are different are: (a) Contracts of Purchase financed by Qualified Mortgage Bond Proceeds have more restrictions on the right of a purchaser to assume the obligations under the Contract of Purchase than do Contracts of Purchase financed by Unrestricted Moneys or Qualified Veterans Mortgage Bond Proceeds; and (b) certain Contracts of Purchase financed by Qualified Mortgage Bond Proceeds are subject to recapture provisions. In addition, the Federal Tax Code contains numerous loan eligibility restrictions on borrowers receiving financing from proceeds such as Qualified Mortgage Bond Proceeds. These restrictions require, among other things, and subject to certain exceptions contained in the Federal Tax Code, that borrowers (i) not have had a present ownership interest in their principal residence during the three-year period preceding the extension of financing, (ii) are eligible to finance the purchase of residences with purchase prices not in excess of limits stated in the Federal Tax Code, (iii) must not have family incomes in excess of limits stated in the Federal Tax Code, (iv) may not use the proceeds of the financing to refinance an existing mortgage loan and (v) may use the proceeds of the financing only to finance one-family or one-to-four family dwelling units meeting certain criteria. The Federal Tax Code includes certain procedures that an issuer of Qualified Mortgage Bonds may undertake to satisfy these requirements but requires that 95% or more of the proceeds of the issue be used in full compliance with the loan eligibility restrictions.

Since the number and value of Contracts of Purchase relating to farms and mobile homes, and Contracts of Purchase financed pursuant to the 1943 Act are statistically insignificant, the discussion below is limited to Contracts of Purchase financed under the 1974 Act for homes, excluding farms and mobile homes in rental parks, unless otherwise indicated. See Exhibit 2 to this APPENDIX B—"Certain Department Financial Information and Operating Data—Contracts of Purchase—Existing Contracts of Purchase."

Origination. The Veterans Code, in most cases, requires the veteran to make an initial payment of 2% of either the purchase price or the market value of the property, whichever is less. The balance of the purchase price, including USDVA guaranty fees, may be amortized over a period fixed by the Department, not exceeding 30 years and 32 days for all Contracts of Purchase guaranteed by USDVA, and 40 years of any other Contracts of Purchase. Department policy is to issue all new Contracts of Purchase for terms of 30 years. Existing contracts are occasionally extended beyond 30 years in cases of extreme financial hardship.

A Loan Origination Fee ("LOF") of 1% is collected at close of escrow on all contracts issued after January 1, 1999. This fee must be paid in escrow by the buyer or seller. If the loan application is submitted through an approved mortgage broker, the 1% fee is paid directly to the broker through the escrow. Otherwise, the fee is retained by the Department. While the Department's field offices will continue to originate Contracts of Purchase, the Department expects the bulk of the Contracts of Purchase to be originated by mortgage loan brokers in the future. The brokers will deal directly with the central underwriting, escrow and administrative staff in Sacramento, not through the Department's field offices. An appraisal fee of \$300 to \$425 is collected from the applicant and is paid directly to the appraiser upon completion of the assignment. In rare cases, where the appraisal is performed by a Department employee, the fee is retained by the Department.

The Veterans Code permits the Department to finance permanent home and property improvements for veterans with existing Contracts of Purchase. Total financing, including the balance of the original loan, the amount of the improvement loan, and any other encumbrances, cannot exceed 90% of the improved market value of the property. Typically this total LTV ratio is much lower than 90%. Improvement loans are not approved for veterans who have had significant delinquencies in the 12 months immediately preceding the application. Funds are disbursed by the Department directly to the contractors (or vendors) as the improvements are completed. A separate Contract of Purchase is executed which bears interest at the same rate as the existing contract. The new Contract of Purchase is payable over a term up to 15 years based on the amount of the Contract of Purchase. In no event can the term, from the inception of the original Contract of Purchase through the pay-off of the improvement Contract of Purchase, exceed 40 years. A LOF of 1.5% of the improvement Contract of Purchase amount is charged. The maximum home improvement loan for veterans funded with Qualified Mortgage Bond Proceeds is \$15,000 over the term of the original Contract of Purchase. Home improvement loans funded with Unrestricted Moneys or Qualified Veterans Mortgage Bond Proceeds are available up to a maximum of \$50,000. Subsequent home improvement Contracts of Purchase may be granted, if funds are available, so long as there is only one home improvement Contract of Purchase to any veteran outstanding at any time.

Contracts of Purchase for the purchase of a building site and construction of a home are available. Qualifying sites include undeveloped sites/acreage, lots in subdivision developments, and sites in non-profit self help developments. Mobile homes in parks do not qualify. Construction of the improvements must be performed by a licensed California contractor. The Department does not submit Contracts of Purchase which finance home construction for USDVA guaranty during the construction phase. Procedures are being developed to obtain guaranties on the properties once construction is completed.

The Department also limits availability of financing to veterans on the basis of their personal credit status. The Department's current lending criteria conform to those of the USDVA for participation in the USDVA guaranty program for all Contracts of Purchase, including those not eligible for USDVA guarantees. Department procedures are consistent with those established by USDVA for its loan guaranty program.

The history of the Department's originations of Contracts of Purchase, is set forth in Exhibit 2 to this APPENDIX B—"Certain Department Financial Information and Operating Data—Contracts of Purchase—Contracts of Purchase Origination and Principal Repayment Experience."

Servicing. All Contracts of Purchase originated prior to April 1, 1998 or on or after July 1, 1999 are being serviced by the Department utilizing the Department's new Integrated Loan Processing and Financial Information System which became operational on July 1, 1999. All Contracts of Purchase originated between April 1, 1998 and July 1, 1999 are serviced under a contract with Leader under which Leader provides loan servicing, including USDVA reporting. Leader will continue to service those particular Contracts of Purchase until such time as the Department blends them into the new information system. It is expected that the Department will take over the servicing of the Leader serviced Contracts of Purchase prior to the expiration of the Leader agreement on February 1, 2000. However, the terms of the Leader contract do allow for an extension of up to one additional year.

Late penalty charges are applied to Contracts of Purchase that have a remaining amount due of \$25 or more at the close of any account month. A \$10 late penalty charge is imposed on Contracts of Purchase originated before October 1984. Contracts of Purchase originated during and after October 1984 are subject to a late penalty charge of 4% of the principal and interest portion of the installment, consistent with penalties authorized by USDVA.

The Department may, in any individual case and for good cause, permit the postponement from time to time, and upon such terms as it deems proper, of the payment of the whole or any part of any installment. Contracts of Purchase may also have terms in excess of 30 years if home improvement loans have been obtained, as discussed above. The terms of Contracts of Purchase guaranteed by USDVA, however, cannot exceed 30 years and 32 days.

Prepayments. The Department currently imposes on Contracts of Purchase executed prior to April 1, 1998 a prepayment charge equivalent to 2% of the original purchase price if the Contract of Purchase is paid in full within two years of its origination date. After the two-year period has elapsed the veteran may prepay without charge any or all of the installments still remaining unpaid. In conformance with USDVA program requirements, there is no prepayment penalty on all Contracts of Purchase executed after April 1, 1998.

Cancellations and Delinquencies. The Department's policies regarding delinquencies and cancellations conform to USDVA loan guaranty program requirements. In the event of a failure to comply with any of the terms of a Contract of Purchase, the Department may cancel the Contract of Purchase and be released from all obligations, at law or in equity, to convey the property. In such event, the veteran's rights under the Contract of Purchase may be forfeited and all payments made by the veteran prior to termination of the Contract of Purchase deemed to

be rental paid for occupancy. Upon such forfeiture, the Department takes possession of the property covered by the Contract of Purchase and resells it.

If a veteran does not make a payment by the close of the account month in which the payment is due (usually the 18th day of the month), the payment is considered "delinquent." A warning letter is issued on the 20th day of the same account month which advises the veteran that the account is delinquent. Department personnel initiate telephone contact with veterans with delinquent accounts. If the account remains delinquent through the second account month, a Notice of Intent to Cancel Contract is issued at the beginning of the third account month giving notice that the Contract of Purchase may be canceled at the end of the 30-day notice period unless the account is brought current. A schedule for liquidation of delinquent payments satisfactory to the Department is arranged during this period; *however*, if the account remains delinquent after such 30-day period and no schedule for liquidation of delinquent payments has been agreed upon, the Department may begin cancellation of the Contract of Purchase. The Department's headquarters Central Collections Unit monitors the delinquency throughout this process, orders a title search to identify any junior lienholders and forwards the pertinent information to the Department's Foreclosure Unit for further precancellation processing in accordance with the California Code of Regulations, Title 12, Section 344, Military and Veterans Affairs. Junior lienholders are identified and sent notices giving them 30 days (40 days in the case of federal tax liens) to protect their interest by beginning foreclosure proceedings. If the account is not brought current during such notice period to junior lienholders and no junior lienholder proceeds with a foreclosure action to protect its interest, the Department's Foreclosure Unit cancels the contract, and a Notice of Cancellation is mailed to the veteran and recorded. The Department's Foreclosure Unit then takes steps to evict occupants and clear any remaining liens. If judicial action is required, the case is referred to the Department's Law Division for additional processing.

After all remaining liens are removed and the property is vacant, the repossessed property is repaired and improved, if necessary, and is marketed through the Department's centralized repossession sales unit. The Department is required to advertise and accept sealed offers after a 2-week period, and the property is sold to the highest acceptable bidder. If no acceptable bids are received, the property is sold through a real estate broker and a commission of between 3% to 6% of the selling price is paid.

Federal law provides certain protections to military personnel on active duty or reservists ordered to report for military service under The Soldiers' and Sailors' Civil Relief Act of 1940, as amended. If a veteran obtained a Contract of Purchase prior to the relevant period of military service, then during the period of military service the interest rate on the Contract of Purchase cannot exceed 6% (unless the ability of the veteran to pay interest in excess of 6% is not materially impaired by such military service). Also, the veteran may seek a stay (or a court may on its own motion grant a stay) of any court action or proceeding.

See Exhibit 2 to this APPENDIX B—"Certain Department Financial Information and Operating Data—Cancellations and Delinquencies" for additional information regarding the status of Contracts of Purchase.

Interest Rates. Contracts of Purchase originated prior to January 1, 1999 bear interest at a rate which is set at least annually by the Department, with the review of the Board and the Veterans' Finance Committee of 1943. Most of such Contracts of Purchase currently bear interest at a rate of 6.95%. The Veterans Code currently requires that, generally, all Contracts of Purchase originated prior to January 1, 1999 bear the same interest rate. In accordance with the current provisions of the Veterans Code, the interest rate for such Contracts of Purchase can be changed at any time and as often as necessary. The effective date of a higher rate of interest on Contracts of Purchase may occur only once in any calendar year unless a finding is made by the Board and the Veterans' Finance Committee of 1943 that such additional action is necessary to protect the solvency of the 1943 Fund.

Legislation passed in 1998 (i) eliminated the uniform interest rates requirement for Contracts of Purchase originated on or after January 1, 1999 and (ii) allows the Department to establish non-uniform fixed or variable interest rates for such Contracts of Purchase. The current interest rates for such Contracts of Purchase are: 5.95% for Contracts of Purchase financed using Qualified Mortgage Bond Proceeds, and 6.65% for all other loans.

Loan Insurance

The Department has completed several programmatic changes, including obtaining loan insurance from private primary mortgage insurers for certain new and existing Contracts of Purchase with high LTVs and USDVA guaranties for most new Contracts of Purchase with high LTVs. The Department collects a funding fee of from 1.25% up to 3% of the Contract of Purchase amount, based on the LTV for all Contracts of Purchase which exceed an LTV of 80%. With respect to eligible Contracts of Purchase, this fee is paid to the USDVA for the cost of the loan guaranty. The fee may be paid in escrow by the buyer or seller, or it may be added to the base loan amount. If the veteran or the property is not eligible for a USDVA loan guaranty, the funding fee is placed in the Self Insurance Mortgage Loss Set-Aside Account. A portion of the fee is used to purchase primary mortgage insurance.

Primary Mortgage Insurance. The Department has purchased primary mortgage insurance for a pool of certain Contracts of Purchase with LTVs above 80% but not to exceed 97%. This insurance is being provided through a contract with Radian. The Radian policy provides coverage back to February 1, 1998, for aggregate losses incurred on Contracts of Purchase in the pool, following property disposition, above an aggregate 2% deductible based upon a percentage of originally insured balances. Under the Radian policy, once the aggregate deductible has been reached, insurance claims may be made based upon the individual LTV of the particular defaulted Contract of Purchase, as set forth below. For these purposes, LTV is calculated using the original appraised value of the property.

**Radian Mortgage Insurance Coverage Rates Subject to a
Deductible of 2% of the Total Original Dollar Amount of the Insured Pool**

<u>LTV Category</u>	<u>% of Coverage</u>
95.01 % to 97.00 %.....	35 %
90.01 % to 95.00 %.....	30 %
85.01 % to 90.00 %.....	25 %
80.01 % to 85.00 %.....	17 %

The Department intends to include Contracts of Purchase with 80.01% to 97% LTV ratios that are not qualified for USDVA guaranties (except mobile homes in parks, construction loans and home improvement loans all of which are covered by the Department) in the 2% aggregate loss primary mortgage insurance contract with Radian unless and until the aggregate principal amount of Contracts of Purchase so insured by Radian exceeds the coverage amount of the insurance contract. At present the remaining available coverage amount under such Radian contract is approximately \$145,000,000, although Contracts of Purchase in an aggregate principal amount of \$25,705,974 are currently in process for coverage under the Radian policy. The Department expects that if the remaining coverage amounts under the Radian contract are exhausted, the Department will attempt to obtain a similar contract, to the extent feasible and at a reasonable cost. See Exhibit 2 to this APPENDIX B—"Certain Department Financial Information and Operating Data—Contracts of Purchase—Existing Contracts of Purchase" and -Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments."

USDVA Guaranty Program. The Department has been approved by the USDVA as a "supervised lender with automatic processing authority" as of March 10, 1998. On July 27, 1998, the Department received USDVA approval under the Lender Appraisal Processing Program ("LAPP") to process appraisals and determine reasonable value without prior USDVA review. The Department seeks USDVA loan guaranties for all Contracts of Purchase with an LTV ratio of 80% or higher, unless the Contract of Purchase is not eligible for USDVA guaranty. Contracts of Purchase not eligible for guaranty are primarily contracts with veterans who have previously used their USDVA guaranty eligibility and do not qualify for reinstatement, and contract for the purchase of new homes not inspected by USDVA during construction. A very small number of veterans have service that meets Veterans Code eligibility requirements but does not meet USDVA eligibility requirements.

The Servicemen's Readjustment Act of 1944, as amended, permits a veteran (or in certain instances the veteran's spouse) to obtain a mortgage loan guaranty from USDVA covering mortgage financing of the purchase or construction of a one-to-four family dwelling unit at interest rates permitted by USDVA. The USDVA program has no preset mortgage loan limits and permits the guaranty of mortgage loans of up to 30 years and 32 days' duration. Under the USDVA program, the maximum USDVA guaranty on a loan is the lesser of the veteran's available entitlement (a maximum of \$36,000, or if the original loan amount exceeds \$144,000, a maximum of \$50,750), or (1) 50% of the original loan amount if such amount does not exceed \$45,000, (2) \$22,500 if the original loan amount is between \$45,000 and \$56,250, (3) the lesser of \$36,000 or 40% of the original loan amount, if such amount is between \$56,250 and \$144,000, or (4) the lesser of \$50,750 or 25% of the original loan amount, if such amount is in excess of \$144,000. The liability on the guaranty is reduced or increased pro rata with any

reduction or increase in the amount of indebtedness, but in no event will the amount payable on the guaranty exceed the amount of the original guaranty. Notwithstanding the dollar and per centum limitations of the guaranty, a mortgage holder will ordinarily suffer a monetary loss only where the difference between the unsatisfied indebtedness and the proceeds of a foreclosure sale of a mortgaged property is greater than the original guaranty as adjusted. Extended periods without interest payments prior to foreclosure will also increase the potential for losses. In the event of a default in the payment of a USDVA loan, but prior to a suit or foreclosure, USDVA may, at its option, pay to a mortgage holder the unpaid balance of the obligation plus accrued interest and receive an assignment of the loan and security.

Self Insurance Mortgage Loss Set-Aside. The Department has established a mortgage loss account within the 1943 Fund to be funded by mortgage insurance charges (funding fees) paid by veteran recipients of Contracts of Purchase that do not qualify for USDVA guarantees and high LTV Contracts of Purchase that are not insured under the Radian policy.

Property and Life and Disability Insurance

The Veterans Code and/or long-standing Department policy have called for a veteran to maintain certain insurance with respect to the property covered by a Contract of Purchase. Insurance must be in the amount and under the conditions specified by the Department, and is either provided by the Department or by insurance companies selected by the Department.

Fire and Hazard Coverage. The Department self-insures for fire and hazard losses, using the 1943 Fund to make payments, up to a deductible. The Master Policy described below (the "Master Policy") provides coverage in excess of the deductible, except that the Master Policy does not cover mobile homes, condominiums or planned unit development properties covered by blanket insurance policies provided by homeowners' associations. The Master Policy is provided by a commercial insurer.

Under each Contract of Purchase, the veteran is required to pay the sum charged to his or her account to cover costs of providing the insurance coverage including the insurance premium due under the Master Policy described below with respect to his or her property. From the amount charged to each veteran, the Department retains a portion to provide the sums necessary to pay all losses up to \$1,250,000 per occurrence or \$10,000,000 per policy year. If the total losses from a single occurrence exceed \$1,250,000 or if the aggregate of all fire and hazard insurance losses for a policy year exceed \$10,000,000 liability for the excess will be covered under the Master Policy. The current Master Policy will be renewed for a one-year period effective on October 31, 1999.

The Master Policy is an all-physical loss form. Fire and hazard insurance coverage for participants in the Program is adjusted annually to reflect increasing building costs and is maintained on a guaranteed replacement cost basis for homes and on an actual cash value basis for outbuildings. A \$250 deductible payable by the veteran applies to each loss. Claims must be submitted within 12 months of loss. Each veteran with a Contract of Purchase pays an annual insurance premium equal to \$0.22 per \$100 of insured value which is prorated and included in the veteran's monthly installment. Claims adjustments and payments are made on behalf of the Department and the provider of the Master Policy by an affiliate of such provider.

Disaster Indemnity Plan. The Department provides certain disaster indemnity and catastrophe real property insurance ("Disaster Indemnity Plan"). Neither such insurance nor the indemnity fund described below are payable from or a part of the 1943 Fund. The Disaster Indemnity Plan indemnifies participants against the cost of repairing damage in excess of a deductible caused by flood, earthquake or other perils not covered by the fire and hazard insurance policy (not otherwise excluded). The deductible for flood losses is \$500 and the deductible for earthquake losses is \$500 or 5% of the amount of loss, whichever is higher. The catastrophe insurance has been obtained from a consortium of nineteen insurance companies for a total of \$50,000,000 of coverage with a \$4,000,000 per occurrence and in the aggregate annually; \$100,000 per occurrence maintenance deductible thereafter. The 1999 to 2001 annual premium for this coverage is \$5,100,000.

Each veteran in the Program participates in the Disaster Indemnity Plan and pays his or her pro rata share of the annual premium. Such payments are deposited in an indemnity fund created in the Treasury of the State to be utilized to pay the deductible discussed above. Each veteran pays an initial assessment of \$1.35 per \$1,000 of insured value, and any assessments as may be required to sustain the indemnity fund. The value of the indemnity fund as of June 30, 1999 was \$14,849,384.

Effective December 1, 1997, the Department has purchased individual flood policies through the Federal Emergency Management Agency ("FEMA") covering all properties financed by Contracts of Purchase that are located in designated flood zones. Coverage under this policy extends to December 1, 2000.

Life and Disability Coverage. In the past, the Department self-insured from the 1943 Fund life and disability coverage for veterans with Contracts of Purchase. Following a period of significant and recurring losses incurred by the 1943 Fund (see "THE 1943 FUND—Selected Financial Data of the 1943 Fund and Department's Discussion" in this APPENDIX B), the Department, effective June 1, 1996, replaced most of the Department's self-insured life and disability insurance program with an interim life and disability insurance plan (the "Life and Disability Plan") provided by PM Group Life Insurance Company ("PM Group"). Effective February 1, 1998, the interim plan after a competitive bidding process was replaced by a replacement, long-term life insurance and disability plan, also provided by PM Group Life Insurance. The Department continues to self-insure those veterans who were already receiving disability benefits at the time the Life and Disability Plan was implemented. Benefits are equal to the amount of the monthly Contract of Purchase payment at the time of their disability. Those benefits will continue under the provisions of the self-insured plan until the beneficiary returns to active employment or dies, or his contract is paid off. Loss reserves for these obligations are actuarially based. A portion of the required loss reserves are maintained under a third-party administrator agreement and are shown in the financial statements for the 1943 Fund as investments with insurance administrators. The remaining amount is unfunded, but reserved in the form of a loss against retained earnings. See "THE 1943 FUND—Selected Financial Data of the 1943 Fund and Department's Discussion" in this APPENDIX B.

Effective February 1, 1998, the Department implemented a new life and disability protection plan which is provided by PM Group. All holders of Contracts of Purchase who had life and disability coverage under the prior plan were transferred automatically to the new plan. Major elements of the life and disability coverage will continue unchanged for all currently insured Contract of Purchase holders up to age 60. For formerly insured holders of Contracts of Purchase under age 60, 100% of the loan balance is covered. Life insurance coverages at subsidized rates for those currently insured Contract of Purchase holders in the program over age 60 are limited to a maximum of the loan amount or \$75,000, if less, reducing in increments every 5 years to a maximum of \$5,000 after age 80. Such Contract of Purchase holders can obtain, at actuarial rates, full coverage. Holders of new Contracts of Purchase after February 1, 1998 are covered under a revised insurance plan. The Department continues to require life insurance coverage but in an amount sufficient to cover home payments for five, three or one year(s) depending on the health of the individual loan applicant. All new Contract of Purchase applicants must apply and must be provided the minimum life insurance coverage. Disability coverage for a period up to two years is optional for new Contract of Purchase holders after February 1, 1998, but is a mandatory requirement for Contract of Purchase holders with Contracts of Purchase in existence prior to February 1, 1998. The disability insurance benefit provides home loan protection by paying the participant's monthly loan installment (including insurance premiums) for a maximum benefit period of two years per disability, unless due to a psychiatric condition which would then limit the maximum benefit period to 12 months. Additional, full coverage, life insurance may also be purchased as an option by new Contract of Purchase holders. Spouse life insurance coverage is available as an option. The new plan is an experience rate plan subject to annual rating reviews of insurance claims, expenses, risk charges, profits and premiums. In addition to the new insurance coverages, the Department has established a one-time \$5 million rate stabilization reserve, which the Department will retain with interest as part of the 1943 Fund.

THE 1943 FUND

General

The components of the 1943 Fund are (i) proceeds derived from the sale of Revenue Bonds, (ii) proceeds of Veterans G.O. Bonds, (iii) amounts receivable under all Contracts of Purchase and from sales of properties subject to canceled Contracts of Purchase, (iv) temporary investments, cash and funds, and (v) certain other miscellaneous assets. Proceeds of Veterans G.O. Bonds may not be applied to payment of principal of, and interest or any redemption premium on, the Revenue Bonds. The holders of Revenue Bonds are not entitled to compel the sale of Contracts of Purchase and the properties to which they relate, but are entitled to receive payment out of the Revenues derived from those Contracts of Purchase and properties, subject to the prior claims, if any, of the Veterans G.O. Bonds.

In addition to financing Contracts of Purchase and paying or reimbursing of debt service on the Veterans G.O. Bonds and Revenue Bonds, as described below, moneys in the 1943 Fund are used to pay administrative costs of the Department, and to fund certain losses from and reserves for property insurance and life and disability insurance described above in this APPENDIX B under "THE PROGRAM—Property and Life and Disability Insurance."

While the 1998 Financial Statement for the 1943 Fund reflected an increase in retained earnings, the Department's 1999 Financial Statement for the 1943 Fund reflects a loss in retained earnings. In addition, the Program has experienced significant losses during other recent fiscal years in the retained earnings in the 1943 Fund. For additional information, see below "Selected Financial Data of the 1943 Fund and Department's Discussion" and also see Exhibit 1 to this APPENDIX B—"Financial Statements of the 1943 Fund for Fiscal Years 1999 and 1998 and Independent Auditor's Report."

The Act and the Veterans Code provide that the undivided interest created by Resolution RB-1 in favor of the holders of Revenue Bonds in the assets of the 1943 Fund is secondary and subordinate to the interest of the people of the State and the holders of Veterans G.O. Bonds. Moneys in the 1943 Fund must be paid, on the debt service payment dates of Veterans G.O. Bonds, to the General Fund in the amount of the principal of (whether at maturity or upon redemption or acceleration), and premium and interest on Veterans G.O. Bonds then due and payable (other than debt service payable from the proceeds of refunding bonds). Debt service on Veterans G.O. Bonds is payable from the General Fund, even if the amount transferred from the 1943 Fund to the General Fund is less than such debt service amount. The balance remaining unpaid must be transferred to the General Fund out of the 1943 Fund as soon thereafter as it becomes available, together with interest thereon at the rate borne by the applicable Veterans G.O. Bonds, compounded semiannually. Until such amounts are repaid to the General Fund; no payments may be made on the Revenue Bonds other than from amounts then in the Bond Reserve Account and the Loan Loss Account. These rights with respect to the 1943 Fund do not grant any lien on the 1943 Fund or the moneys therein to the holders of any Veterans G.O. Bonds.

As of June 30, 1999, there were outstanding \$2,687,390,000 aggregate principal amount of Veterans G.O. Bonds and \$404,215,000 aggregate principal amount of Revenue Bonds. As of June 30, 1999, \$176,835,000 of Veterans G.O. Bonds are authorized but not issued, and the Department may in the future seek voter approval for additional amounts of Veterans G.O. Bonds. The Offered Veterans G.O. Bonds will not use any of such authorized amount. Under the Act, Revenue Bonds in an aggregate principal amount not to exceed \$1,500,000,000, at any given time, may be outstanding. The Legislature may increase the amount of Revenue Bonds issuable under the Act or may decrease such amount to an amount not less than the amount of Revenue Bonds then outstanding. See "THE OFFERED VETERANS G.O. BONDS—Purpose" for information about the issuance of the Offered Veterans G.O. Bonds. Additional information about outstanding Veterans G.O. Bonds and Revenue Bonds is in Exhibit 2 to this APPENDIX B—"Certain Department Financial Information and Operating Data—Veterans G.O. Bonds and Revenue Bonds."

See "THE DEPARTMENT—LAO Reports and Governor's Budget" in this APPENDIX B for a discussion of suggestions that moneys in the 1943 Fund be applied to finance benefits for veterans outside the Program.

See "THE OFFERED VETERANS G.O. BONDS—Purpose" for a discussion of the Department's reductions of the interest rates on existing Contracts of Purchase and the interest rate for new Contracts of Purchase. For additional information regarding the existing interest rates of, and setting interest rates on, Contracts of Purchase, see "THE PROGRAM—Contracts of

Purchase" in this APPENDIX B and Exhibit 2 to this APPENDIX B—"Certain Department Financial Information and Operating Data—Contracts of Purchase."

Selected Financial Data of the 1943 Fund and Department's Discussion

Selected Financial Data of the 1943 Fund

The following selected financial data of the 1943 Fund for fiscal years ended June 30, 1999 and 1998 has been derived from the financial statements of the 1943 Fund audited by Deloitte & Touche LLP, independent auditors, whose report thereon appears in Exhibit 1 to APPENDIX B in this Official Statement. The following selected financial data of the 1943 Fund for fiscal years ended June 30, 1997, 1996 and 1995 has also been derived from the audited financial statements of the 1943 Fund which are not included herein. This selected financial data should be read in conjunction with the financial statements and notes thereto of the 1943 Fund contained in said Exhibit 1 and the Department's Discussion of Financial Data contained herein.

Beginning with the fiscal year ended June 30, 1998, the financial statements of the 1943 Fund are required to reflect accounting changes required by promulgation of Statement No. 31 by the Governmental Accounting Standards Board ("GASB 31"). GASB 31 requires all investments to be reported at their fair market value (rather than book value) and investment income to be adjusted to reflect the difference between the fair market and book value of investments as either a capital gain or loss. The financial data derived from the financial statements of the 1943 Fund for FY 1995 through FY 1997 and presented in the tables below have been adjusted to reflect the impact of GASB 31 on investments and investment income so as to make such data consistent with the accounting procedures used in preparing the FY 1998 and FY 1999 financial statements.

The impact of GASB 31 adjustments over the five-year period reflected in the tables below (including FY 1999) are a cumulative decrease of \$2,983,000 in the deficiency of revenues over expenses and cumulative increase of the same amount in retained earnings.

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SELECTED FINANCIAL DATA OF THE 1943 FUND
(Thousands of Dollars)

	<u>June 30, 1999</u>	<u>June 30, 1998</u>	<u>Restated June 30, 1997</u>	<u>Restated June 30, 1996</u>	<u>Restated June 30, 1995</u>
ASSETS AND LIABILITIES RELATED TO LENDING AND FINANCING ACTIVITIES:					
CASH AND INVESTMENTS					
Cash and amounts on Deposit in SMIF	239,979	325,321	317,178	295,140	306,269
Guaranteed Investment Contracts	890,692	938,888	365,542	475,744	591,449
Treasury Securities	<u>183,645</u>	<u>187,851</u>	<u>347,214</u>	<u>363,426</u>	<u>395,113</u>
Total	1,314,316	1,452,060	1,029,934	1,134,310	1,292,831
DUE FROM VETERANS DEBENTURE REVENUE FUND					
	22,471	12,686	86,279	137,141	137,166
OTHER CURRENT ASSETS	18,335	13,755	22,596	26,191	25,787
NET OTHER NON-CURRENT ASSETS	33,262	36,406	15,123	15,824	16,600
CONTRACTS OF PURCHASE					
Performing Contracts	2,040,587	2,035,879	2,154,142	2,231,994	2,356,818
Non Performing Contracts	<u>28,669</u>	<u>62,872</u>	<u>75,038</u>	<u>74,268</u>	<u>53,257</u>
Total	2,069,256	2,098,751	2,229,180	2,306,262	2,410,075
Allowance For Contract Losses	(21,263)	(22,005)	(26,412)	(15,801)	(15,066)
Reduction of REO to Fair Value	<u>(8,104)</u>	<u>(19,003)</u>	<u>(24,003)</u>	<u>(17,113)</u>	<u>(12,334)</u>
Total	<u>(29,367)</u>	<u>(41,008)</u>	<u>(50,415)</u>	<u>(32,914)</u>	<u>(27,400)</u>
BONDS PAYABLE					
General Obligation Bonds	(2,687,390)	(2,947,165)	(2,632,045)	(2,812,810)	(3,002,695)
Revenue Bonds	<u>(404,215)</u>	<u>(275,055)</u>	<u>(327,580)</u>	<u>(374,975)</u>	<u>(434,545)</u>
Total	<u>(3,091,605)</u>	<u>(3,222,220)</u>	<u>(2,959,625)</u>	<u>(3,187,785)</u>	<u>(3,437,240)</u>
OTHER CURRENT LIABILITIES	<u>(56,369)</u>	<u>(58,458)</u>	<u>(80,502)</u>	<u>(86,716)</u>	<u>(90,868)</u>
Net Lending & Financing Activities					
Assets	<u>280,299</u>	<u>291,972</u>	<u>292,570</u>	<u>312,313</u>	<u>326,951</u>
ASSETS AND LIABILITIES RELATED TO INSURANCE ACTIVITIES:					
LIFE AND DISABILITY COVERAGE					
Deposits with Insurance Administrators	30,573	40,823	48,762	56,843	65,246
Insurance Reserves and Claims Payable	<u>(39,751)</u>	<u>(53,185)</u>	<u>(65,828)</u>	<u>(78,246)</u>	<u>(79,729)</u>
Total	(9,178)	(12,362)	(17,066)	(21,403)	(14,483)
FIRE AND HAZARD COVERAGE					
Net Insurance Reserves and Claims Payable	<u>(1,552)</u>	<u>(1,209)</u>	<u>(1,405)</u>	<u>(2,744)</u>	<u>(5,013)</u>
Net Insurance Activities Liabilities	<u>(10,730)</u>	<u>(13,571)</u>	<u>(18,471)</u>	<u>(24,147)</u>	<u>(19,496)</u>
RETAINED EARNINGS	<u>269,569</u>	<u>278,401</u>	<u>274,099</u>	<u>288,166</u>	<u>307,455</u>
SUMMARY INFORMATION					
Total Assets	3,435,000	3,587,000	3,377,000	3,639,000	3,916,000
Total Liabilities	3,159,000	3,309,000	3,103,000	3,351,000	3,609,000
Total Number of Contracts of Purchase	32,243	35,906	39,343	42,650	47,075

SELECTED FINANCIAL DATA OF THE 1943 FUND
(Thousands of Dollars)

	<u>June 30, 1999</u>	<u>June 30, 1998</u>	<u>Restated June 30, 1997</u>	<u>Restated June 30, 1996</u>	<u>Restated June 30, 1995</u>
NET INCOME FROM LENDING AND FINANCING ACTIVITIES:					
INTEREST INCOME					
Interest on Contracts	139,839	162,086	175,186	182,636	181,595
Interest on Investments	75,292	74,077	67,373	79,510	76,846
Transfer of Interest From Veterans Debtenture Revenue Fund	<u>887</u>	<u>3,317</u>	<u>10,843</u>	<u>11,144</u>	<u>11,164</u>
Total	216,018	239,480	253,402	273,290	269,605
BOND INTEREST EXPENSE	<u>(201,772)</u>	<u>(218,757)</u>	<u>(230,871)</u>	<u>(245,971)</u>	<u>(252,792)</u>
Net Interest Income (Expense)	<u>14,246</u>	<u>20,723</u>	<u>22,531</u>	<u>27,319</u>	<u>16,813</u>
GASB 31 ADJUSTMENT	<u>(6,897)</u>	<u>(4,578)</u>	8,420	(12,580)	18,618
GAIN ON SALE OF SECURITIES	2,351	13,460			
RESTRUCTURING EXPENSES	<u>(6,342)</u>	<u>(3,068)</u>			
	<u>(10,888)</u>	<u>5,814</u>	<u>8,420</u>	<u>(12,580)</u>	<u>18,618</u>
CONTRACTS OF PURCHASE					
PMI	(2,330)	(1,551)			
Net loss on Sale of REO'S	(3,886)	(3,128)	(8,309)	(5,510)	(2,200)
Increase in Allowance for Contract Losses	<u>3,343</u>	<u>(1,312)</u>	<u>(22,677)</u>	<u>(5,515)</u>	<u>(10,463)</u>
Total	(2,873)	(5,991)	(30,986)	(11,025)	(12,663)
Net Lending/Financing Activities Income (Expense)	<u>485</u>	<u>20,546</u>	<u>(35)</u>	<u>3,714</u>	<u>22,768</u>
NET INCOME FROM ADMINISTRATIVE ACTIVITIES					
Operating Revenues	3,826	1,891	2,290	1,769	2,768
Operating Expenses	<u>(19,543)</u>	<u>(20,381)</u>	<u>(20,218)</u>	<u>(18,810)</u>	<u>(17,675)</u>
Net Administrative Activities Expense	<u>(15,717)</u>	<u>(18,490)</u>	<u>(17,928)</u>	<u>(17,041)</u>	<u>(14,907)</u>
NET INCOME FROM INSURANCE ACTIVITIES					
Life and Disability Coverage	5,290	160	3,570	(5,424)	(13,781)
Fire and Hazard Coverage	<u>1,110</u>	<u>2,086</u>	<u>326</u>	<u>(538)</u>	<u>(4,202)</u>
Net Insurance Activities Income (Expense)	<u>6,400</u>	<u>2,246</u>	<u>3,896</u>	<u>(5,962)</u>	<u>(17,983)</u>
TOTAL DEFICIENCY OF REVENUES AND TRANSFERS OVER EXPENSES	<u>(8,832)</u>	<u>4,302</u>	<u>(14,067)</u>	<u>(19,289)</u>	<u>(10,122)</u>
RETAINED EARNINGS	<u>269,569</u>	<u>278,401</u>	<u>274,099</u>	<u>288,166</u>	<u>307,455</u>

Department's Discussion of Financial Data

The 1943 Fund, which is the sole operating fund for the Program, reflects a retained earnings balance of \$269,569,000 as of June 30, 1999. This represents a \$8,832,000 decrease compared to FY 1998 and is approximately 15.1% below the level at the beginning of FY 1995. Although retained earnings have decreased in four of the last five years, the overall asset-to-liability ratio for the 1943 Fund has remained nearly constant at approximately 108% during the same period. The deficiency of revenues over expenses for the Program for FY 1999 was \$8,832,000 compared to an excess of revenues over expenses of \$4,302,000 in FY 1998. The aggregate net deficiency of revenues for the Program during the five-year period reflected in the tables above was \$48,008,000.

As further described below, the Program has experienced significant losses during four of the last five years for four principal reasons: (i) a low interest rate environment that produced high prepayment levels and decreased investment earnings on invested funds from FY 1995 through FY 1998; (ii) reductions of interest rates on existing Contracts of Purchase (as discussed below) in excess of the near term reduction of interest expense achieved through bond refundings in 1997 and 1998; (iii) losses on sale of repossessed properties and allowances for losses associated with the Department's portfolio of Contracts of Purchase from FY 1995 through FY 1998; and (iv) financial losses associated with the Department's self-insured life and disability and property insurance programs during FY 1995 and FY 1996. However, as discussed below, over the last several years the Department has undertaken major initiatives to address each of these areas and expects such actions to have a positive impact on future years' financial performance.

The Program's FY 1999 net interest income (total interest income less bond interest expense) of \$14,246,000 was \$6,477,000 less than FY 1998. During the first three years represented in the table above net interest margin (net interest income divided by average interest bearing assets) improved, reflecting the Department's continuing efforts during the period to reduce debt service cost and increase interest income. These efforts have included, where possible, redemption of outstanding higher interest rate bonds prior to maturity and the transfer of certain invested funds from lower yielding variable rate instruments to higher yielding fixed rate investments. Notwithstanding these recent actions, the Department's net interest margin declined from 0.65% in FY 1997 to 0.41% in FY 1999 and will continue to be adversely affected in future years by the: (i) reduction of the interest rate on existing Contracts of Purchase from 8.00% to 6.95% implemented effective April 1, 1998; and (ii) \$792,110,000 (as of June 30, 1999) of outstanding Veterans G.O. Bonds issued in series without early redemption provisions, with average interest costs of approximately 9.00% and which cannot be fully retired before the year 2010 (see Exhibit 2 to this APPENDIX B—"Certain Department Financial Information and Operating Data—Veterans G.O. Bonds and Prior Revenue Bonds").

In addition, income was negatively affected in FY 1999 compared to FY 1998 by a \$13,428,000 decline in the effect of realized and unrealized gains on securities due to changes in market value. During FY 1999, such income was also negatively affected by full-year amortization of \$6,342,000 of the financing and redemption costs relating to the issuance of the 1997/1998 Tax Plan Bonds and subsequent similar costs, and by premium costs of \$2,330,000 relating to the purchase of private mortgage insurance with respect to certain Contracts of

Purchase--both of which are expected to represent recurring expenses for future years' operations.

Like all loan portfolios, the Program experienced fluctuating levels of prepayments and new originations of Contracts of Purchase primarily influenced by the rates of interest of conventional mortgage financing relative to the Program's interest rates (either 8.00% or 7.75% during the period reflected in the table above until March 31, 1998, and 6.95% thereafter). The net effect of these factors resulted in the outstanding principal balance of Contracts of Purchase declining 14.1% since June 30, 1995. (See Exhibit 2 to this APPENDIX B—"Certain Department Financial Information and Operating Data" for detailed information regarding the history of repayments, prepayments and originations of Contracts of Purchase.) During the first three years of such period, cash and invested funds dropped 20.3% due primarily to the use of such assets to pay bond maturities or redeem bonds and fund new Contracts of Purchase. During FY 1998, cash and investments increased by \$422,126,000 primarily as the result of issuance of the 1997/1998 Tax Plan Bonds which provided \$353 million of new funds to originate Contracts of Purchase. During FY 1999 cash and investments declined \$137,744,000 due primarily to the use of proceeds of the 1997/1998 Tax Plan Bonds to originate new Contracts of Purchase. In aggregate, total Program assets have declined 12.3% since June 30, 1995. The debt structure of the Program, however, accommodated this downward trend in assets through a series of bond redemptions which resulted in a similar reduction in the bonds outstanding. Other non-current assets increased by \$18,139,000 compared to June 30, 1997 due primarily to the capitalization of financing and redemption costs relating to the 1997/1998 Tax Plan Bonds. Such non-income producing assets will be amortized over the term of the 1997/1998 Tax Plan Bonds and will have a negative effect on net income during such period.

Due to the decline in real estate values in certain California housing sub-markets in the early 1990's and the concentration of the Department's Contract of Purchase portfolio in certain areas of the State which were economically depressed due to military base closures and defense industry employment reductions, the number of repossessed properties ("REOs") and their loss on sale increased significantly between FY 1992 and FY 1997. However, the principal balance of Contracts of Purchase classified as REOs decreased by \$46,469,000 from June 30, 1997 to June 30, 1999 compared to a \$42,738,000 cumulative increase over the preceding four-year period. Beginning in FY 1996, the Department moved aggressively to repossess properties of canceled Contracts of Purchase and dispose of its REOs. In conjunction with this effort, the Department reassessed the adequacy of its loss reserves and, over the five-year period FY 1994 to 1998, took cumulative net charges to its operating income by \$50,804,000 to provide for potential losses in the portfolio. During FY 1999, the Department's loss allowance was reduced by \$3,343,000 due to the adequacy of reserves funded in prior years and improvement in the overall performance of the Contracts of Purchase portfolio. As a result of actual losses realized in the disposition of REO properties and management of the Contracts of Purchase portfolio, accumulated loss reserves decreased \$21,048,000 or 41.7% over the last two years. The remaining loss reserve of \$29,367,000 at June 30, 1999, together with the Department's (a) purchase of primary mortgage insurance during FY 1998 with respect to more than \$769 million of existing Contracts of Purchase with high LTV ratios; and (b) imposition of USDVA guaranties for most new high LTV Contracts of Purchase originated beginning last year (see "THE PROGRAM—Loan Insurance" in this APPENDIX B), are expected to provide for future potential REO losses.

Program administrative operating expenses declined 4.1% in FY 1999. After taking into account a \$1,935,000 increase in operating revenue, net administrative operating expenses decreased 15.0% over FY 1998 results.

Effective June 1, 1996, the Department's self-insured life and disability coverage plan was transferred to a fully-insured plan underwritten by an outside commercial insurer except for that portion of the program covering existing claims of disabled Contract of Purchase holders for whom the Department continues to provide coverage. Loss reserves for these obligations have been actuarially based. More than two-thirds of such loss reserves are funded and maintained under a third party administrator agreement. The remaining amount is unfunded, but reserved in the form of an accrued liability. The net effect of these changes resulted in the plan producing positive income since FY 1997 compared to aggregate losses of \$36,373,000 over the four preceding fiscal years.

Effective November 1, 1996, a number of changes were made to the Department's fire and hazard insurance coverage, including increasing the deductible, eliminating outdated loss coverages and limiting the claims period. These changes have resulted in stabilized financial operations for the Department's fire and hazard coverage over the last four fiscal years.

Further financial information relating to the 1943 Fund can be located in Exhibit 1 to this APPENDIX B in this Official Statement.

LAO Reports and Governor's Budget

The Legislative Analyst's Office for the State of California (the "LAO"), on January 16, 1998, issued a report entitled "Rethinking the Cal-Vet Loan Program." On February 16, 1999, the LAO issued an analysis of the then proposed Governor's Budget 1999/2000, which analysis included a discussion of the Department. (The report and the analysis are referred to collectively as the "LAO Reports.") The stated purpose of the LAO is to provide analysis and nonpartisan advice to the California Legislature on fiscal and policy issues. The LAO is overseen by the Joint Legislative Budget Committee, a 14-member bipartisan committee composed of an equal number of State Assembly and State Senate members.

In the LAO Reports, the LAO analyzed the historical and recent financial performance and lending activities of the Department and made various recommendations. The LAO Reports described the financial losses experienced by the Department, the increasing rate of repayment of Contracts of Purchase, and the decreased lending activity in recent years. The LAO Reports attributed the decreased lending activity principally to more attractive loan programs available from other sources and to a dwindling population of eligible veterans. The budget analysis stated that the Department's completed and proposed programmatic changes (including changing from the uniform interest rate) had improved borrower demand, although less than the Department had projected, and the Department's bond restructuring program, implemented with the sale of over \$1.4 billion of Veterans G.O. Bonds and Revenue Bonds in 1997 and 1998, had improved the Department's financial operations. The LAO Reports were issued before the impact of the Department's recent programmatic changes had been realized.

However, the LAO's analysis of the interests of the State and of the future needs of veterans and funding sources led to several recommendations, which included increased oversight of the Department, ending new loan origination after the year 2007, and use of Department moneys which the LAO considered "surplus" for the benefit of veterans and State taxpayers. The 1998 report stated that any redirection of "surplus funds should be accomplished carefully by means that ensure that all obligations of the [S]tate to Bondholders are met." Any further actions on the LAO Reports would result from legislative changes that would be proposed by the Legislature and signed by the Governor. In addition, the LAO budget analysis states that any such use of surplus funds would have to be authorized through a ballot measure.

In his proposed budget for Fiscal Year 1999-2000, Governor Davis cites the 1998 report when discussing the Department, and refers to "a basic dilemma: there is a declining interest or need for home loans and an increasing need for other services for veterans." The Governor listed several steps intended to improve the operation of State programs for veterans. Those most relevant to the Program are (a) appointment of an internal auditor for the Department, (b) a request to the Bureau of State Audits to conduct a fiscal and program compliance audit of the Program, which, with other studies, will lay the groundwork for corrective action, and (c) direction to the Secretary of Veterans Affairs to report within 6 months to the Governor on the need for further restructuring of the Program and on ways that the "surplus funds in the home program" might be redirected to other pressing needs of veterans.

On October 10, 1999, Governor Davis signed into law Assembly Bill 92, which creates the Office of Inspector General for Veterans Affairs. Once appointed by the Governor and confirmed by the Senate, the inspector general will be responsible for reviewing the operations and financial condition of all veterans programs supported by the State, which includes the Program. The Department has been advised by the Bureau of State Audits that no audit of the Program has been scheduled at this time.

As directed by the Governor's budget language for Fiscal Year 1999-2000, on July 12, 1999 the Department submitted a report to the Governor which addressed the Department's intent to further enhance the programmatic changes implemented in the 1997/1998 restructuring plan and advised the Governor that there are no "surplus" funds in the home program as the term implies. No new directives have been issued to the Department.

The financial performance of and loan origination by the Department are discussed elsewhere in this Official Statement. The Department does not believe that either termination of loan originations after 2007 or use of Department moneys to fund other programs, if either or both of these policies were implemented, would have an adverse impact on the Department's ability to pay scheduled principal of and interest on any Veterans G.O. Bonds or Revenue Bonds. While the Legislature could enact any or all of the recommendations in the LAO Report, use of moneys in the 1943 Fund for veterans benefits outside of the Program may be subject to approval by the electorate of the State and may also be subject to other legal restrictions.

Litigation

On June 25, 1996, the Department was served with a summons and complaint initiating a lawsuit entitled *John L. Debbs, et al. v. California Department of Veterans Affairs, et al.* (Superior Court of California, County of Los Angeles, Case No. BC 151476). The third amended complaint alleges "fraudulent concealment, declaratory relief, injunctive relief, and damages for monies unlawfully taken from the California Veterans Farm and Home Life and Disability Protection Plan." Plaintiff claims that in 1983, when the Department canceled its contracts with two life insurance companies then responsible for underwriting the life and disability programs, over \$100 million was illegally expended by the Department, and that certain transfers from the life and disability reserves to the 1943 Fund were unlawful. The complaint seeks, among other things, that premiums under the life and disability program be reduced to prior levels and the return of the moneys, plus interest, from the 1943 Fund to the life and disability reserves. Plaintiffs' attempts to obtain a preliminary injunction and temporary restraining order from the court have been unsuccessful. Plaintiffs sought to convert this action into a class action suit. The court certified the class action but ordered the Plaintiffs' attorney to pay the cost of notifying the class. The court ordered Plaintiffs to provide notice to the class by December 27, 1999, and, thereafter, summary judgment motions will be scheduled.

The Department is vigorously opposing this class action lawsuit. While the outcome of any litigation cannot be predicted with certainty, the Department expects ultimately to prevail in this matter. Even if the respective Plaintiffs should prevail in this matter, the Department does not expect such outcome to affect its ability to make timely payment of debt service on the Veterans G.O. Bonds or the Revenue Bonds.

In 1997, John L. Debbs and his wife filed a separate federal court action. In 1998, Mr. and Mrs. Debbs filed an additional federal court action, essentially repeating the charges and damages contained in the 1997 action. Both federal court actions have been dismissed by the court and no further appeals are available.

Excess Revenues

The Department has covenanted with the holders of its Revenue Bonds to apply Revenues received with respect to Contracts of Purchase, after payment or reimbursement of debt service on Veterans G.O. Bonds, in a specified order or priority. For this purposes, "Revenues" means all moneys received by or on behalf of the Department representing (i) principal and interest payments on the Contracts of Purchase including all prepayments representing the same and all prepayment premiums or penalties received by or on behalf of the Department in respect to the Contracts of Purchase, (ii) interest earnings received on the investment of amounts to the extent deposited in the revenue account established under the resolution authorizing the issuance of revenue bonds (the "Revenue Bond Resolution"), (iii) amounts transferred to the revenue account from the bond reserve account or the loan loss amount established under the Revenue Bond Resolution, and (iv) any other amounts payable by parties executing Contracts of Purchase or private participants in the Program or related to recoveries on defaulted Contracts of Purchase, including origination and commitment fees, servicing acquisition fees, and liquidation/insurance proceeds, except to the extent not included as "Revenues" pursuant to the provisions of any resolution authorizing the issuance of a series of Revenue Bonds.

The Department has covenanted with the Revenue Bond holders to administer the 1943 Fund and the Program and perform its obligations to such holders in accordance in all material respects with the then-current Program Operating Procedures. The Program Operating Procedures are operating policies of the Department governing the discretionary activities of the Department under the Revenue Bond Resolution. The Department may amend the Program Operating Procedures. The Program Operating Procedures will affect the Excess Revenues that will become available to redeem the Bonds.

The Department has covenanted with the Revenue Bond holders to apply Revenues in the following order, after paying, or reimbursing for payments of, debt service on Veterans G.O. Bonds, including the costs of liquidity and credit enhancement facilities related thereto, and setting aside moneys as required under the Federal Tax Code to preserve the tax-exempt status of certain Veterans G.O. Bonds and Revenue Bonds, (1) to pay debt service on Revenue Bonds, (2) to pay the costs of liquidity and credit enhancement facilities, if any, for Revenue Bonds, (3) to replenish certain reserve funds established for the Revenue Bonds, (4) if the Department elects, to pay Department expenses, (5) to set aside a monthly accrual of Veterans G.O. Bond debt service, (6) if the Department elects, to finance Contracts of Purchase, and (7) with respect to Excess Revenues and certain tax restricted moneys, to redeem Veterans G.O. Bonds, including the Bonds, and Revenue Bonds. For such purposes:

(a) "Excess Revenues" means, as of any date of calculation, Revenues in excess of Accrued Debt Service;

(b) "Accrued Debt Service" means, as of any date of determination and, as the context requires, with respect to all Revenue Bonds and Veterans G.O. Bonds (including the Offered Veterans G.O. Bonds), the sum of:

(i) the aggregate amount of scheduled interest and principal (except to the extent otherwise to be redeemed pursuant to clause (i) or (ii) below) to become due after such date but on or before the end of the current debt service year, less the product of (i) the number of whole months remaining in the current debt service year and (ii) the Monthly Debt Service Requirement;

(ii) the redemption price of bonds for which notice of redemption has been issued, provided such redemption price is to be paid from amounts on deposit in the revenue account created under the Revenue Bond Resolution; and

(iii) the redemption price of bonds that the Department will be obligated to redeem prior to the end of the next succeeding debt service year, to the extent that such obligation arises on account of amounts on deposit in such revenue accounts; and

(c) "Monthly Debt Service Requirements" means, as of any date of termination, one-twelfth of the aggregate amount of scheduled interest and principal to become due during the debt service year in which such date falls, as computed on the first day of such debt service year.

Maintenance of Fund Parity

The Revenue Bond Resolution requires the Department to calculate "Fund Parity" at least annually. "Fund Parity" means (a) an amount equal to the difference between (i) all assets in the 1943 Fund and in the accounts established under the Revenue Bond Resolution, and (ii) the principal amount of all Revenue Bonds and Veterans G.O. Bonds outstanding (plus accrued interest) reduced by (b) defined allowances and reserves for loss coverage on Contracts of Purchase and life and disability coverage on persons obligated under Contracts of Purchase. If any such calculation shall not reflect that Fund Parity at least equals the percentage required by the Revenue Bond Resolution, the Department may be required to expend Excess Revenues to redeem Revenue Bonds until its recalculations of Fund Parity meet the test required by the Revenue Bond Resolution.

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EXHIBIT 1

**FINANCIAL STATEMENTS OF THE 1943 FUND
FOR FISCAL YEARS 1999 AND 1998
AND INDEPENDENT AUDITORS' REPORT**

**VETERANS FARM AND HOME BUILDING FUND OF 1943
DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA**

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**INDEPENDENT AUDITORS' REPORT**

To the California Veterans Board
State of California
Sacramento, California

We have audited the accompanying balance sheets of the Veterans Farm and Home Building Fund (Fund) of 1943, which is administered by the Department of Veterans Affairs of the State of California (Department) as of June 30, 1999 and 1998, and the related statements of revenues, expenses and changes in retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Veterans Farm and Home Building Fund of 1943, and are not intended to present the financial position of the Department of Veterans Affairs of the State of California and the results of its operations and cash flows of its proprietary fund types.

In our opinion, such financial statements referred to above present fairly, in all material respects, the financial position of the Veterans Farm and Home Building Fund of 1943, Department of Veterans Affairs of the State of California as of June 30, 1999 and 1998, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

The year 2000 supplementary information on page 15 is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board, and we did not audit and do not express an opinion on such information. Further, we were unable to apply to the information certain procedures prescribed by professional standards because of the unprecedented nature of the year 2000 issue and its effects, and the fact that authoritative measurement criteria regarding the status of remediation efforts have not been established. In addition,

we do not provide assurance that the Department is or will become year 2000 compliant, that the Department's year 2000 remediation efforts will be successful in whole or in part, or that parties with which the Fund does business are or will become year 2000 compliant.

Deloitte's Touche LLP
October 1, 1999'

**VETERANS FARM AND HOME BUILDING FUND OF 1943,
DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA**

BALANCE SHEETS

JUNE 30, 1999 AND 1998 (in thousands)

	1999	1998
ASSETS		
Cash in State Treasury		\$ 6,553
Investments:		
Unrestricted	\$ 464,965	571,598
Restricted	849,351	873,909
Insurance administrators	<u>32,423</u>	<u>42,673</u>
	1,346,739	1,488,180
Total cash and investments	1,346,739	1,494,733
Receivables under contracts of sale, net of allowance for uncollectible contracts of \$21,263 and \$22,005 in 1999 and 1998	2,019,324	2,013,874
Due from Veterans Debenture Revenue Fund	22,471	12,686
Interest receivable:		
State of California's Surplus Money Investment Fund	3,998	3,101
Other investments	8,214	9,608
Due from other funds	6,123	1,046
Other real estate owned, net of allowance for losses of \$8,104 and \$19,003 in 1999 and 1998	20,565	43,869
Land, improvements and equipment, net of accumulated depreciation of \$6,986 and \$5,972 in 1999 and 1998	7,578	8,620
Other	<u>466</u>	<u>92</u>
TOTAL ASSETS	<u>\$3,435,478</u>	<u>\$3,587,629</u>
LIABILITIES AND RETAINED EARNINGS		
LIABILITIES:		
Cash overdraft due to State Treasury	\$ 6,393	
Accrued interest and other liabilities	49,976	\$ 58,458
Bonds payable - net	3,066,387	3,194,526
Insurance claims payable and loss reserves	<u>43,153</u>	<u>56,244</u>
Total liabilities	3,165,909	3,309,228
RETAINED EARNINGS	<u>269,569</u>	<u>278,401</u>
TOTAL LIABILITIES AND RETAINED EARNINGS	<u>\$3,435,478</u>	<u>\$3,587,629</u>

See notes to financial statements.

**VETERANS FARM AND HOME BUILDING FUND OF 1943,
DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA**

**STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN RETAINED EARNINGS
YEARS ENDED JUNE 30, 1999 AND 1998 (in thousands)**

	1999	1998
PROGRAM OPERATIONS:		
Interest revenues:		
Contracts of sale of properties	\$ 139,839	\$ 162,086
Investments and other	74,079	78,621
Transfers of revenue from Veterans Debenture Revenue Fund	<u>887</u>	<u>8,441</u>
Total program operations revenues	214,805	249,148
Expenses:		
Interest expense	201,772	218,757
Provision for contract losses (reversal)	<u>(3,343)</u>	<u>1,312</u>
Total program operations expenses	<u>198,429</u>	<u>220,069</u>
Excess of program operations revenues over program operations expenses	<u>16,376</u>	<u>29,079</u>
PROGRAM ADMINISTRATION:		
Revenues:		
Loan servicing fees	3,261	1,594
Other income	565	297
Excess of amounts charged to contract holders over fire and hazard insurance claims and expenses and changes in insurance reserves	1,110	2,086
Excess of amounts charged to contract holders and changes in insurance reserves over self-insured life and disability claims and expenses	<u>1,957</u>	<u> </u>
Total program administration revenues	6,893	3,977
Expenses:		
Payroll and related costs	11,171	11,404
General and administrative expenses	17,044	13,596
Excess of self-insured life and disability insurance claims and expenses and changes in insurance reserves over amounts charged to contract holders	<u> </u>	<u>626</u>
Total program administration expenses	<u>28,215</u>	<u>25,626</u>
Excess of program administration expenses over program administration revenues	<u>(21,322)</u>	<u>(21,649)</u>
LOSS ON SALE OF REPOSSESSED PROPERTY	<u>(3,886)</u>	<u>(3,128)</u>
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENSES	(8,832)	4,302
RETAINED EARNINGS:		
Beginning of year	<u>278,401</u>	<u>274,099</u>
End of year	<u>\$ 269,569</u>	<u>\$ 278,401</u>

See notes to financial statements.

**VETERANS FARM AND HOME BUILDING FUND OF 1943,
DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA**

**STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 1999 AND 1998 (in thousands)**

	1999	1998
CASH FLOWS FROM OPERATING ACTIVITIES:		
Excess (deficiency) of revenues over expenses	\$ (8,832)	\$ 4,302
Adjustments to reconcile to net cash used by operating activities:		
Amortization of bond premiums, discounts and issuance costs	3,207	2,494
Depreciation expense	1,042	727
Loss on sale of repossessed property	3,886	3,128
Effect of changes in assets and liabilities:		
Interest receivable - State of California's Surplus		
Money Investment Fund	(897)	(2,624)
Interest receivable - other investments	1,394	8,158
Due from other funds	(5,077)	3,307
Other real estate owned	19,418	4,038
Other assets	(374)	884
Accrued interest and other liabilities	(8,482)	(22,044)
Insurance claims payable and loss reserves	(13,091)	(12,839)
Net cash used by operating activities	<u>(7,806)</u>	<u>(10,469)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net (increase) decrease in receivables under contracts of sale	(5,450)	113,856
Net (increase) decrease in investment securities	141,441	(421,607)
Purchase of land, improvements and equipment		(1,513)
Net cash provided (used) by investing activities	<u>135,991</u>	<u>(309,264)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Increase in cash overdraft due to State Treasury	6,393	
Proceeds from sales of bonds	591,755	1,613,366
Maturities of bonds payable	(82,235)	(1,325,996)
Early redemption of bonds payable	(640,866)	(48,650)
Net (increase) decrease in Due from Veterans Debenture Revenue Fund	(9,785)	74,793
Net cash provided (used) by financing activities	<u>(134,738)</u>	<u>313,513</u>
DECREASE IN CASH IN STATE TREASURY	(6,553)	(6,220)
CASH IN STATE TREASURY:		
Beginning of year	<u>6,553</u>	<u>12,773</u>
End of year	<u>\$ -</u>	<u>\$ 6,553</u>

See notes to financial statements.

VETERANS FARM AND HOME BUILDING FUND OF 1943, DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA

NOTES TO FINANCIAL STATEMENTS YEARS ENDED JUNE 30, 1999 AND 1998

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Description - The California Department of Veterans Affairs (the Department) is a separate legal entity and a Cabinet level agency of the State of California. A seven-member California Veterans Board (the Board) has policy oversight of the operations of the Department. The Board's membership consists of the Department Secretary and six members, all of whom are appointed by the Governor, subject to confirmation by the State Senate. The Veterans Farm and Home Building Fund of 1943 (the Fund) was established under the authority of the California Constitution to provide low-interest, long-term farm and home mortgage loan contracts to veterans living in California. The contract loan program has been continuous since 1922. Proceeds from the sale of general obligation bonds, periodically authorized by the vote of the people of California, and revenue bonds authorized by the Legislature are used for contract loans to veterans. Expenditures are primarily for debt service and administration of the program. The Fund is tax exempt.

The financial statements represent only the activities of the Veterans Farm and Home Building Fund of 1943, and are not intended to present the financial position of the Department of Veterans Affairs of the State of California and the results of its operations and cash flows of its proprietary fund types. The financial statements of the Fund are included in the financial statements of the State of California as the State represents the primary government and has ultimate oversight responsibility for the Fund.

Use of Estimates in the Preparation of Financial Statements - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Basis of Accounting - The Fund has been classified as a governmental proprietary fund type for accounting purposes. Generally, revenues are recorded when earned and expenses are recognized as incurred.

Cash and Investments - The Department reports all investments at fair value except for certain nonparticipating fixed interest investment contracts which are valued using cost based measures. The fair value of investments is based on published market prices and quotations from major investment brokers and from the State of California for the Surplus Money Investment Fund. Uncommitted bond proceeds restricted for loans to veterans are reflected in the balance sheet as restricted cash and investments.

Receivables Under Contracts of Sale - Receivables under contracts of sale consist of the remaining contract principal balance plus unpaid interest accrued to date, net of the reserve for uncollectible accounts. The contract balance may also include amounts paid by the Fund for property taxes and insurance pending reimbursement from the contract holder.

Allowance for Uncollectible Contracts - The allowance for uncollectible contracts is established through a provision charged to operations. The allowance is an amount that management believes will be adequate to absorb losses inherent in existing contracts and commitments to extend credit, based on evaluations of the collectibility and prior loss experience of contracts and commitments to extend credit. The evaluations take into consideration such factors as changes in the nature and volume of the portfolio, overall portfolio quality, specific problem contracts, commitments, and current and anticipated economic conditions that may affect the borrowers' ability to repay the obligation.

Contract Guarantees and Primary Mortgage Insurance - During 1998, the Department started collecting a contract guarantee fee on all contracts with down payments less than 20%. Such contracts are classified as high loan to value (HLTV) contracts. For eligible borrowers, the fee is used to purchase contract guarantees from the U.S. Department of Veterans Affairs (USDVA) or primary mortgage insurance. For certain HLTV contracts not eligible for USDVA guarantees, the Fund purchases primary mortgage insurance (PMI) from Radian Guaranty Inc., formerly, the Commonwealth Mortgage Assurance Company. The PMI provides lifetime coverage on the HLTV contracts, not covered by USDVA guarantees, subject to an aggregate 2% deductible. The Department is responsible for any losses not covered by the USDVA guarantees or the PMI.

Other Real Estate Owned - Real estate acquired by repossession is carried at the lower of the contract balance or its net realizable value. After repossession, the value of the underlying contract is written down to the estimated fair value of the real estate, if necessary. Any subsequent write-downs are charged against operating expenses. Operating expenses of such properties, net of any related income, are included in other expenses.

Insurance Claims Payable and Loss Reserves - Insurance claims payable and loss reserves include unpaid claims, incurred but not reported (INBR) claims and loss reserves for the fire and hazard insurance plan and the benefits payable under the Department's remaining self-insured life and disability protection plan.

Fire and Hazard Insurance - This insurance program is provided to eligible contract holders as part of the loan program. The difference between premiums charged to contract holders and claims and expenses incurred and the change in loss reserves is included as a net amount in the statement of revenues, expenses and changes in retained earnings.

Self-Insured Life and Disability Protection Plan - Beginning in 1984, the Department operated a self-funded protection plan whereby life and disability insurance was provided to eligible contract holders. This plan was terminated June 1, 1996. The life and disability benefits previously available to these members under the self-insured protection plan continue to be available to those contract holders who were receiving benefits at the time the plan was terminated. Loss reserves to satisfy these obligations of the protection plan which include future disability and life benefits were derived from an actuarial evaluation performed in 1997. Significant actuarial assumptions and methodologies used to calculate the reserve are interest, mortality, disability, prepayment, and a long-term discount rate of 7%.

Amortization of Bond Premiums, Discounts and Issuance Costs - Premiums and discounts arising from the issuance of bonds and expenses incurred in connection with the issuance of bonds are capitalized and amortized using the monthly amortization method, which approximates the interest method.

New Accounting Pronouncements - In June 1999, the Governmental Accounting Standards Board issued Statement of Governmental Accounting Standards ("SGAS") No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*. The statement establishes financial reporting standards for certain governmental entities which will require expanded

financial information, management discussion and analysis and required supplemental information in their financial reporting. This statement will be effective for the Department for the year ended June 30, 2002. The Department has not determined what effect adopting SGAS No. 34 will have on the Fund's financial statements.

2. CASH AND INVESTMENTS

The cash overdraft of \$6,393,464 as of June 30, 1999 represents a liability due to the State Treasury. Cash in the State Treasury of \$6,552,580 as of June 30, 1998 represents amounts held in the Fund's general operating accounts with the State Treasury. These monies are pooled with the monies of other State agencies and invested by the State Treasurer's office. These assets are not individually identifiable.

Investment of bond funds is restricted by applicable California law and the various bond resolutions associated with each issuance, generally, to certain types of investments, including direct obligations of the U.S. Government and its agencies, the State of California's Surplus Money Investment Fund, and investment agreements with financial institutions or insurance companies rated within the top two ratings of a nationally recognized rating service. The investments with the insurance administrator, held as a deposit in accordance with a master agreement for the remaining active life and disability insurance program for disabled contract holders, is authorized by California law. In addition, the Department has restricted \$5,000,000 plus interest accrued since February 1, 1998, for potential life and disability rate increases after January 31, 2002.

The Fund's investments in master investment agreements totaling \$890,692,585 as of June 30, 1999 are carried at cost. The interest rates on investment agreements are fixed and range from 4.98% to 5.91%. The investment agreements expire from 2000 to 2029.

All of the Fund's investments in U.S. Treasury notes and bonds, corporate bonds, and the amounts administered by the insurance company are categorized as risk category 1, which is defined by GASB Statement No. 3 as investments that are insured or registered or for which the securities are held by the Fund or its agent in the Fund's name. In accordance with GASB Statement No. 3, the Fund's investments held in the State of California's Surplus Money Investment Fund, the investment agreements and the mutual fund are not categorized as to risk.

The Fund's investments at June 30, 1999 and 1998 are as follows (in thousands):

	1999	1998
Category 1		
U.S. Treasury notes and bonds	\$ 183,645	\$ 187,851
Amounts held in trust fund with insurance administrators:		
U.S. Treasury notes	15,627	15,331
Corporate bonds	9,596	16,186
Other	4,371	4,378
Investments Not Subject to Categorization		
State of California's Surplus Money Investment Fund	239,979	318,768
Investment agreements (at cost)	890,692	938,888
Amounts held in trust fund with insurance administrators:		
Mutual fund	<u>2,829</u>	<u>6,778</u>
	<u>\$1,346,739</u>	<u>\$1,488,180</u>

3. RECEIVABLES UNDER CONTRACTS OF SALE

The Fund retains title to all real property subject to contracts of sale until the contract is satisfied. The veteran's contracts have original terms of 25-30 years and bear interest at rates of 4.4% to 11.0%, depending on the age and type of contract and the classification of the current contract holder. During 1998, the Department lowered the rate on most contracts from 8.0% to 6.95%.

4. BONDS PAYABLE

At June 30, 1999 and 1998, bonds payable included the following (in thousands):

	1999	1998
General obligation bonds of the State of California, annual interest rates from 4.1% to 11.0% due in varying annual installments through 2032 (subject to varying redemption provisions)	\$2,687,390	\$2,947,165
Home purchase revenue bonds, annual interest rates from 3.9% to 5.5%, due in varying annual installments through 2028 (subject to varying redemption provisions)	<u>404,215</u>	<u>275,055</u>
	3,091,605	3,222,220
Discounts	(4,276)	(4,358)
Premiums		214
Unamortized bond origination costs	(12,370)	(11,454)
Unamortized bond redemption premiums	<u>(8,572)</u>	<u>(12,096)</u>
Total	<u>\$3,066,387</u>	<u>\$3,194,526</u>

Future scheduled bond maturities at June 30, 1999 are as follows (in thousands):

2000	\$ 186,255
2001	108,825
2002	112,660
2003	111,755
2004	125,980
Thereafter	<u>2,446,130</u>
	<u>\$3,091,605</u>

General obligation bonds of the State of California are payable in accordance with the various veterans bond acts by the State General Fund. The full faith and credit of the State of California is pledged for the payment of both principal and interest. All general obligation bonds have an equal claim against the General Fund of the State of California. These bonds are included as obligations of the Fund when the proceeds from bond sales are received. The repayment for the bonds is the responsibility of the Fund. Authorized and unissued bonds under the Veterans Bond Acts of 1990 and 1996 at June 30, 1999 and 1998 were \$176,835,000.

Revenue bonds are special obligations of the Department payable solely from, and by a pledge of, an undivided interest in the assets of the Veterans Farm and Home Building Fund of 1943 and the Veterans Debenture Revenue Fund, a separate fund of the Department. The undivided interest in the net revenues of the 1943 Fund is secondary and subordinate to any interest or right in the 1943 Fund of the people of the State of California and of the holders of general obligation veterans bonds. At any point in time, authorized and unissued revenue bonds equal the \$1.5 billion ceiling authorized in 1987 less revenue bonds outstanding at that time. At June 30, 1999 and 1998, authorized and unissued revenue bonds were \$1,095,785,000 and \$1,224,945,000, respectively.

During fiscal year 1998, the Department amended the revenue bond resolution provisions regarding the Bond Reserve Account in the Veterans Debenture Revenue Fund (a separate entity). The revenue bond resolution requires the establishment and maintenance of a Bond Reserve Account in an amount equal to at least three percent of the aggregate outstanding principal amount of all Revenue Bonds with interest rates fixed to maturity. To calculate the reserve requirement, the Ninth Supplemental Resolution established, with respect to the revenue bonds with interest rates fixed to maturity issued pursuant to such resolution (1997 Series A Bonds, 1997 Series B Bonds, 1997 Series C Bonds, 1998 Series A Bonds, 1999 Series A Bonds and 1999 Series B Bonds), a requirement equal to at least seven percent of the outstanding principal amount of such Revenue Bonds. Amounts in the Bond Reserve Account shall be used solely for the purposes of paying the principal of and the interest on the Revenue Bonds and for making Mandatory Sinking Fund Account Payments on Revenue Bonds. Amounts on deposit in the Bond Reserve Account as of any date, in excess of the bond reserve requirement, may be transferred out of the Veterans Debenture Revenue Fund to the Fund, at the request of the Department. Investment earnings of the Veterans Debenture Revenue Fund are transferred to the Fund. At June 30, 1999 and 1998 the total assets of the Veterans Debenture Revenue Fund are shown as a receivable of the Fund. Complete financial statements of the Veterans Debenture Revenue Fund, Department of Veterans Affairs, State of California can be obtained by contacting the California Department of Veterans Affairs.

5. BOND REFUNDING

During fiscal year 1999, the Department issued General Obligation bonds totaling \$351,500,000 and Home Purchase Revenue bonds totaling \$240,255,000 with an average interest rate of 5.02%. Certain bond proceeds from the General Obligation bond issues and certain proceeds from the Home Purchase Revenue bond issues were used to refund previously issued General Obligation bonds of \$485,740,000, and Home Purchase Revenue bonds of \$106,015,000.

For those bonds that could not be called for immediate redemption, approximately \$17,295,000 is deposited in an escrow account held by the State Treasurer, as escrow trustee, to provide for all future debt service payments on the defeased bonds. As a result, these bonds are considered to be defeased and the liability for those bonds is not included in the Fund's balance sheet.

During the 1999 fiscal year, the escrow trustee retired approximately \$293,191,000 of bonds which were considered defeased as of June 30, 1998.

6. FIRE AND HAZARD INSURANCE

Fire and hazard insurance coverage is provided on behalf of contract holders for substantially all properties subject to contracts of sale. The program is funded by amounts charged to contract holders which are considered appropriate to cover losses incurred, premiums paid for excess insurance coverage and administration fees. From the amounts charged to contract holders, the Department pays losses up to \$1,500,000 per occurrence or \$12,000,000 per policy year. Coverage in excess of the above amounts is provided under a master policy with an insurance carrier which also administers the program. The loss reserve is based on the third party administrators estimate of incurred but not reported claims based on the historical trends and loss experience within the portfolio.

The excess of premiums charged to contract holders over claims, expenses and change in loss reserves for the year ended June 30, 1999 and 1998 was as follows (in thousands):

	1999	1998
Amounts charged to contract holders	\$ 8,820	\$ 9,788
(Less) plus:		
(Increase) decrease in estimated loss reserve	(370)	29
Claims loss expense	(6,213)	(6,418)
Master policy premium	(478)	(532)
Administrative fees	(649)	(781)
Excess of amounts charged to contract holders over claims and expenses and changes in reserves	<u>\$ 1,110</u>	<u>\$ 2,086</u>

7. SELF-INSURED LIFE AND DISABILITY PROTECTION PLAN

The Department was responsible for a self-insured life and disability protection plan for all contract holders until June 1, 1996. At that time, except for contract holders receiving benefits, the self-insured life and disability protection plan was replaced by an interim life and disability insurance plan provided by a commercial insurer, Pacific Mutual Group (PMG). Effective February 1, 1998, PMG was selected to provide a replacement, long-term life and disability plan.

As of June 30, 1999, the Department remains self-insured for approximately 1,018 remaining contract holders. Under the provisions of the self-insured plan benefits continue until the beneficiary returns to active employment, dies or their contract is paid off. Loss reserves for these obligations have been actuarially determined. A portion of the required loss reserves are maintained under a third party administrator (TPA) agreement and are shown in the financial statements as investments with insurance administrators. During the year, the TPA reserves have been used to satisfy benefits payable under the self-insured protection plan. Earnings on investments held by the TPA were \$2,836,005 and \$2,976,337 in 1999 and 1998, respectively, and are included in interest revenues - investments and other in the financial statements.

The excess of claims expenses, changes in loss reserves, and administrative expenses over plan revenues whose coverages continue as obligations of the self-funded life and disability protection plan for the years ended June 30, 1999 and 1998 was as follows (in thousands):

	1999	1998
Claims expenses:		
Life insurance program	\$ (941)	\$ (1,836)
Disability insurance program	<u>(10,102)</u>	<u>(11,510)</u>
Total claims expenses	(11,043)	(13,346)
Decrease in estimated loss reserves	<u>13,267</u>	<u>12,810</u>
Net claims expenses and change in loss reserves	2,224	(536)
Plus plan revenues:		
Life insurance program	124	157
Disability insurance program	<u>158</u>	<u>179</u>
Total	282	336
Less administrative fees	<u>(549)</u>	<u>(426)</u>
Excess (deficiency) of plan revenues over net claims expense	<u>\$ 1,957</u>	<u>\$ (626)</u>

8. COMMITMENTS AND CONTINGENCIES

As of June 30, 1999 and 1998, the Fund had loan commitments to veterans for the purchase of properties under contracts of sale of approximately \$18,313,948 and \$16,017,616, respectively.

The Department is a defendant in certain litigation related to the self-insured Life and Disability Protection Plan, formerly operated by the Department, and other matters. The Department, based on the advice of its counsel, believes that the suits are without merit and intends to vigorously defend its position. Management is of the opinion that the potential liability will not have a material adverse effect on the financial statements.

The Fund leases several buildings used as district offices. Rent expense for the years ended June 30, 1999 and 1998 was \$435,865 and \$462,562, respectively. Lease terms generally range from five to ten years with options to renew for additional periods. As of June 30, 1999, minimum annual rentals under operating leases are as follows (in thousands):

2000	\$ 245
2001	140
2002	<u>34</u>
	<u>\$ 419</u>

9. RETIREMENT PLAN

The Fund, through the Department and the State of California, contributes to the California Public Employees Retirement System (CalPERS), which includes an agent multiple-employer public employee retirement system and a cost sharing multiple-employee plan that acts as a common investment and administrative agent for participating entities within the State of California. Substantially all full-time employees of the Department, whose compensation is paid from the Fund, are members of CalPERS. The Plan provides a monthly allowance based on age, years of credited service, and highest average compensation over an established period of time of one to three years. Vesting occurs after five to ten years. The Plan also provides death and disability benefits. The benefits are established by contract with CalPERS in accordance with the provisions of the Public Employees Retirement Law. CalPERS issues a publicly available Comprehensive Annual Financial Report (CAFR) that includes financial statements and required supplementary information for CalPERS. A copy of that report may be obtained by writing to CalPERS, Central Supply, P.O. Box 1802, Sacramento, CA 95812-1802.

Contributions to the Plan are funded by both the Department and the employee, and are actuarially determined by CalPERS based on covered compensation. State employees, with the exception of employees in the second-tier plan, are required to contribute to the fund. The contribution rates of active plan members are based on a percentage of salary over a monthly base compensation amount of \$238 to \$863. With the exception of employees in the second-tier plan, state employees' required contributions vary from 5% to 8% of their salary over their base compensation amount.

Contributions by the Department to the Plan for the years ended June 30, 1999 and 1998 were approximately \$625,000 and \$956,000, or approximately 8.3% and 8.4% of participants' salaries, respectively. Employee contributions to the Plan for the years ended June 30, 1999 and 1998 were approximately \$457,000 and \$281,000 or approximately 4.1% and 2.5% of participants' salaries, respectively.

For fiscal years ended June 30, 1999 and 1998, the Department's annual pension cost was equal to the Department's required and actual contributions. The required contribution was determined as part of the June 30, 1997 actuarial valuation using the entry age normal actuarial cost method. The actuarial assumptions included (a) 8.25% investment rate of return, and (b) projected salary increases that vary by duration of service. Both (a) and (b) included an inflation component of 3.5%. The actuarial value of the Department's assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a five-year period. The unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll on a closed basis. The remaining amortization period at June 30, 1997 was 32 years. Three-year fund trend information is as follows:

Three-Year Fund Trend Information

Fiscal Year End	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
June 30, 1997	\$ 1,042,000	100 %	\$ -
June 30, 1998	\$ 956,000	100 %	\$ -
June 30, 1999	\$ 625,000	100 %	\$ -

The most recent actuarial valuation of CalPERS indicated that there was an unfunded liability for vested benefits due current employee participants in the plan. The amount of the unfunded liability applicable to each agency or department cannot be determined. Trend information, which presents CalPERS progress in accumulating sufficient assets to pay benefits when due is presented in the June 30, 1998 CalPERS CAFR.

Since all state agencies and departments are considered by CalPERS collectively as a single employer, the actuarial value of plan assets, the actuarial accrued liability, the total unfunded liability, the actuarial value of assets as a percentage of the actuarial accrued liability, and the ratio of unfunded actuarial liability to annual covered payroll attributable to the Department's employees, whose compensation is paid from the Fund, cannot be determined.

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CALIFORNIA DEPARTMENT OF VETERANS AFFAIRS

REQUIRED SUPPLEMENTARY INFORMATION (Unaudited)

Disclosure of Year 2000 Issues and Activity

The Year 2000 (Y2K) date problem could affect a wide range of governmental activities and could have a significant impact on an entity's future financial resources. In response to this concern, the Governmental Accounting Standards Board (GASB) directed governmental entities to disclose information concerning the general description of the Year 2000 issue as it relates to their organization, the resources committed to resolving the Year 2000 problem, and the stage or stages the organization is at in resolving this problem.

The California Department of Veterans Affairs (the "Department") Farm and Home Division has identified the following systems and equipment as critical to assess and remediate, as necessary, to ensure that the systems and equipment are Year 2000 compliant:

- Mortgage Integrated Tracking Accounting System (Mitas)
- Networks
- Telecommunication Systems
- Desktop PCs and Applications

Stages of Work

The Department has contracted with MIS 2000 for a full-time Y2K Project Manager. Additional Y2K project consultants have been hired to inventory and test all critical systems and equipment. The Department critical system, Mitas, has been certified Y2K compliant by the vendor. Noncompliant desktop applications are being replaced with compliant applications. End-users have been surveyed to identify essential business operations or services that require Y2K planning. The Department expects to complete and test its Continuity Plan for Business by October 31, 1999.

Assessment and Remediation Stages

The inventory and testing of equipment is complete. The Department expects to complete the replacement or upgrading of noncompliant PCs by October 31, 1999. Additionally, the Department has corresponded with all vendors, contractors and others regarding their state of Year 2000 readiness as to the matters affecting the Department.

Validation and Testing Stage

The Department has completed extensive and comprehensive testing with the finding that the Department's internal systems appear to be Year 2000 compliant.

Contingency Planning

The Department has documented manual processes and other alternative courses of action in the event Year 2000 issues arise.

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EXHIBIT 2

CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA

Contracts of Purchase

Set forth below is certain financial information regarding Contracts of Purchase.

Existing Contracts of Purchase

The following charts describe the current loan to value ratios and geographic distribution of Contracts of Purchase financed under the Program as of June 30, 1999 using proceeds of Veterans G.O. Bonds and Revenue Bonds.

Current Loan-to-Value Ratio of Contracts of Purchase⁽¹⁾

	<u>Uninsured</u>	<u>Radian Insured</u>	<u>In Process for Radian Insurance</u>	<u>VA Guaranteed</u>	<u>Total</u>
Single Family Homes					
Less than 30% LTV	\$ 113,632,214	\$ 46,974	--	\$ 20,739	\$ 113,699,927
30-49% LTV	259,109,466	1,748,766	--	54,096	260,912,328
50-59% LTV	189,404,876	1,199,217	--	--	190,604,093
60-69% LTV	203,552,091	3,338,995	--	--	206,891,086
70-79% LTV	241,418,052	23,970,463	--	699,140	266,087,655
Sub-total	<u>\$1,007,116,699</u>	<u>\$ 30,304,415</u>	<u>--</u>	<u>\$ 773,975</u>	<u>\$ 1,038,195,089</u>
80-84% LTV	\$ 13,322,640	\$ 127,575,026	\$ 904,818	\$ 2,064,174	\$ 143,866,658
85-89% LTV	22,273,633	261,455,958	4,195,100	8,072,029	295,996,720
90-94% LTV	36,352,942	296,860,590	9,430,272	25,697,435	368,341,239
95-97% LTV	7,856,026	25,767,978	10,756,343	24,889,124	69,269,471
Sub-total	<u>\$ 79,805,241</u>	<u>\$ 711,659,552</u>	<u>\$ 25,286,533</u>	<u>\$ 60,722,762</u>	<u>\$ 877,474,088</u>
Other High LTV Loans	\$ 36,484,071	\$ 1,987,130	\$ 419,441	\$ 29,518,119	\$ 68,408,761
Total	<u>\$1,123,406,011</u>	<u>\$ 743,951,097</u>	<u>\$ 25,705,974</u>	<u>\$ 91,014,856</u>	<u>\$ 1,984,077,938</u>
Other Property Types					
Farms	\$ 5,860,133	--	--	--	\$ 5,860,133
Mobile Homes in Parks	11,107,617	--	--	--	11,107,617
Total	<u>\$ 16,967,750</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>\$ 16,967,750</u>
Special Status					
Contracts of Purchase					
Real Estate Owned ⁽²⁾	\$ 26,449,962	\$ 2,113,422	--	--	\$ 28,563,384
Disability Program ⁽³⁾	37,280,337	--	--	--	37,280,337
Total	<u>\$ 63,730,299</u>	<u>\$ 2,113,422</u>	<u>--</u>	<u>--</u>	<u>\$ 65,843,721</u>
Total Portfolio	<u><u>\$1,204,104,060</u></u>	<u><u>\$ 746,064,519</u></u>	<u><u>\$ 25,705,974</u></u>	<u><u>\$ 91,014,856</u></u>	<u><u>\$ 2,066,889,409</u></u>

- (1) LTV based on current Contracts of Purchase balance divided by original or updated appraised value of property. Contracts of Purchase are based on the Department's Integrated Loan Processing and Financial Information System.
- (2) Repossessed properties and delinquent Contracts of Purchase carried as REO on financial statements.
- (3) Contracts of Purchase where payments are made on behalf of veterans by the Department's life and disability coverage plan.

Geographic Distribution of Contracts of Purchase

County	Approximate Current Contract Balance
Sacramento	\$ 217,560,106
Los Angeles	158,941,503
San Bernardino	153,378,864
San Diego	111,775,268
Fresno	134,489,810
Kern	102,640,333
Riverside	101,461,753
Orange	97,501,874
Placer	58,462,099
San Joaquin	62,776,012
Solano	61,667,012
Shasta	53,558,897
Contra Costa	50,880,034
Other Northern California Counties	396,576,255
Other Central California Counties	242,986,921
Other Southern California Counties	62,232,668
Statewide--California	<u>\$ 2,066,889,409</u>

Contracts of Purchase Origination and Principal Repayment Experience

The following tables represent, respectively, a historical picture of Contract of Purchase originations since the 1985-86 fiscal year and selected principal repayments with respect to Contracts of Purchase since the 1985-1986 fiscal year.

New Contracts of Purchase During the Fiscal Year⁽¹⁾

Fiscal Year Ending June 30	Veterans G.O. Bonds		Unrestricted Funds		Revenue Bonds		Total	
	Number	Amount	Number	Amount	Number	Amount	Number	Amount
1985	4,196	\$ 290,885,900			2,301	\$ 154,244,600	6,497	\$ 445,130,500
1986	3,484	243,955,800			2,401	160,782,200	5,885	404,738,000
1987	1,569	108,789,700			1,160	75,836,800	2,729	184,626,500
1988	2,958	236,054,500			1,397	99,040,900	4,355	335,095,400
1989	3,112	252,796,300			1,154	83,076,100	4,266	335,872,400
1990	2,097	187,445,600			522	38,150,800	2,619	225,596,400
1991	1,927	200,393,500			359	29,189,600	2,286	229,583,100
1992	1,086	111,600,500			388	34,671,600	1,474	146,272,100
1993	740	94,417,100			286	27,443,800	1,026	121,860,900
1994	843	117,213,779			337	34,740,536	1,180	151,954,315
1995	2,109	286,178,376			822	84,860,894	2,931	371,039,270
1996	762	107,751,444			222	22,723,617	984	130,475,061
1997	766	118,344,636			201	21,853,933	967	140,198,569
1998	615	99,224,002	188	\$ 17,716,376	164	18,871,066	967	135,811,444
1999	758	129,521,359	575	92,728,280	274	33,284,343	1,607	255,533,982

(1) Number of new Contracts of Purchase does not include home improvement loans.

**Selected Principal Flows with respect to Contracts of Purchase
Funded by both Veterans G.O. Bonds and Revenue Bonds**

Fiscal Year Ending June 30	Contracts Funded During Year (000s)	Contract Prepayments During Year (000s)	Other Principal Receipts-Losses During Year (000s)	Contract Balance at End of Year (000s)	Average Base Contract Rate	Average of Monthly FHLMC 30-year		Annual Average Prepayment Rate	Annual Average Origination Rate
						Conventional	Rates		
1985	\$ 445,131	\$ 123,669	\$ 88,308	\$ 3,142,526	8.0%	13.8%		4.1%	14.7%
1986	404,738	179,809	94,970	3,272,485	8.0	11.5		5.6	12.6
1987	184,627	261,675	99,569	3,095,868	7.7	9.8		8.2	5.8
1988	335,095	198,396	114,178	3,118,389	7.0	10.5		6.4	10.8
1989	335,872	207,471	105,896	3,140,894	7.3	10.6		6.6	10.7
1990	225,596	232,085	96,639	3,037,766	8.0	10.1		7.5	7.3
1991	229,583	191,895	92,722	2,982,732	8.0	9.9		6.4	7.6
1992	146,272	246,150	92,975	2,789,879	8.0	9.0		8.5	5.1
1993	121,861	273,817	105,629	2,532,294	8.0	8.0		10.3	4.6
1994	151,954	359,749	98,773	2,225,726	8.0	7.3		15.1	6.4
1995	371,039	111,984	74,706	2,410,075	7.8	8.7		4.8	16.0
1996	130,475	141,767	92,521	2,306,262	8.0	7.5		6.0	5.5
1997	140,199	111,254	106,027	2,229,180	8.0	7.9		4.9	6.2
1998	135,812	172,134	94,106	2,098,752	7.7	7.2		8.0	6.3
1999	255,534	183,776	103,620	2,066,889	6.9	6.9		8.8	12.3
	\$ 3,613,788	\$ 2,995,631	\$ 1,460,639						

Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments

The following table shows amounts expected to become available to fund Contracts of Purchase following the expected remarketing of the Offered Veterans G.O. Bonds. The table includes bonds issued at short-term rates, the proceeds of which will not become available to finance Contracts of Purchase until the interest rates are adjusted to fixed interest rates to maturity. The universe of veterans eligible to receive Contracts of Purchase financed by the different classifications of available moneys is described under "THE PROGRAM--Qualifying Veteran Status." Additional moneys may become available to finance Contracts of Purchase through the future issuances of Veterans G.O. Bonds and Revenue Bonds. The Department has full discretion to use moneys available from prior, current or future bond issues in any order of priority it chooses. For the period covering July 1, 1999 to September 30, 1999, the Department has funded Contracts of Purchase in the amount of approximately \$109,671,000. As of September 30, 1999 the Department had 700 pending applications for Contracts of Purchase in the aggregate amount of approximately \$113,000,000.

Bond Series	Balance as of	Respective Series Bond Proceeds Subaccounts			Investment	Investment Rate (%)
		Unrestricted Moneys ⁽¹⁾	Qualified Veterans Mortgage Bond Proceeds ⁽¹⁾	Qualified Mortgage Bond Proceeds ⁽¹⁾		
Existing Veterans G.O. Bonds						
Series BG, BH, BK, BL.....	6/30/99	-0-	\$ 51,725	-0-	Soc Gen ⁽²⁾⁽³⁾	5.710
Series BM, BN	6/30/99	\$ 46	-0-	-0-	FCMSI ⁽⁵⁾	5.620
Series BM, BN Recycling Subaccount	6/30/99	623	-0-	-0-	WestLB ⁽¹²⁾	5.380
Series BP	6/30/99	-0-	14,000	-0-	Trinity ⁽⁶⁾	5.702
1984 Code G.O. Bond Series Recycling Subaccount	6/30/99	-0-	10,936	-0-	Soc Gen ⁽²⁾⁽³⁾	5.710
Unrestricted G.O. Bond Series Recycling Subaccount 1	6/30/99	52,815	-0-	-0-	Trinity ⁽⁶⁾	5.702
Unrestricted G.O. Bond Series Recycling Subaccount 2	6/30/99	85,651	-0-	-0-	Trinity ⁽⁹⁾	5.210
Series BQ/BR	6/30/99	-0-	80,000	-0-	Trinity ⁽⁷⁾	5.010
Total		<u>\$ 139,135</u>	<u>\$ 156,661</u>	<u>-0-</u>		
Short-Term Veterans G.O. Bonds						
Series BJ 3/4 ⁽⁴⁾	12/1/99	-0-	40,000	-0-	Trinity ⁽¹¹⁾	5.030
Series BJ 5/6 ⁽⁴⁾	6/30/99	-0-	171,500	-0-	BLB ⁽¹¹⁾	5.163
Total		-0-	<u>\$ 211,500</u>	-0-		
New Veterans G.O. Bonds						
Series BJ 7/8 ⁽¹³⁾	12/1/99	-0-	60,000	-0-	BLB ⁽¹³⁾	6.160
Total		-0-	<u>\$ 60,000</u>	-0-		
Total with respect to Veterans G.O. Bonds.....						
		<u>\$ 139,135</u>	<u>\$ 428,161</u>	<u>-0-</u>		
Existing Revenue Bonds						
143 Revenue Bond Series Recycling Subaccount	6/30/99	-0-	-0-	\$ 197,380	Soc Gen ⁽²⁾⁽⁸⁾	5.730
1997 Series A/B and 1998 Series A	6/30/99	-0-	-0-	2,000	SMIF	Variable
1991 Series A Recycling Subaccount	6/30/99	385	-0-	-0-	SMIF	Variable
1999 Series A/B	6/30/99	887	-0-	-0-	SMIF	Variable
Total		<u>\$ 1,272</u>	<u>-0-</u>	<u>\$ 199,380</u>		
Short-Term Revenue Bonds						
1997 Series C ⁽⁴⁾	6/30/99	-0-	-0-	93,000	NatWest ⁽¹⁰⁾	4.980
Total		-0-	-0-	<u>\$ 93,000</u>		
Total with respect to Revenue Bonds.....						
		<u>\$ 1,272</u>	<u>-0-</u>	<u>\$ 292,380</u>		
Total		<u>\$ 140,407</u>	<u>\$ 428,161</u>	<u>\$ 292,380</u>		

Footnotes are on the following page.

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- (1) 000s omitted.
 - (2) On February 1, 1999, Moody's announced that it had placed under review for possible downgrade certain ratings of Societe Generale, including its long-term ratings (senior debts and deposits, currently rated at Aa3 by Moody's) and its bank financial strength rating (currently rated at B by Moody's).
 - (3) Investment agreement maturing December 1, 2000 with Societe Generale.
 - (4) Proceeds will become available only with respect to those bonds on which the interest rate has been adjusted to fixed interest rates to maturity.
 - (5) Investment agreement maturing April 1, 2000 with FGIC Capital Market Services, Inc. ("FCMSI"). The payment obligations of FCMSI under the investment agreement will be guaranteed by General Electric Capital Corporation ("GE Capital").
 - (6) Investment agreement maturing April 1, 2001 with Trinity Plus Funding Company, LLC ("Trinity"). Under certain circumstances, Trinity will have the benefits of a letter of credit from GE Capital and of a revolving liquidity facility under which GE Capital is a lender (there can be additional lenders under the liquidity facility). However, the aggregate of the amounts available under the letter of credit and the liquidity facility may be significantly less than Trinity's obligations under its investment agreements.
 - (7) Investment agreement maturing June 1, 2001 with Trinity. Under certain circumstances, Trinity will have the benefits of a letter of credit and a revolving liquidity facility from GE Capital as described in footnote (6).
 - (8) Investment agreement maturing December 1, 2001 with Societe Generale.
 - (9) Investment agreement maturing December 1, 2001 with Trinity. Under certain circumstances, Trinity will have the benefits of a letter of credit and a revolving liquidity facility from GE Capital as described in footnote (6).
 - (10) Investment agreement maturing December 1, 2001 with National Westminster Bank Plc.
 - (11) Investment agreements as follows: (i) for the Series BJ 3/4 Bonds, with Trinity maturing June 1, 2000, and (ii) for the Series BJ 5/6 Bonds, with Bayerische Landesbank Girozentrale maturing June 1, 2001. Under certain circumstances, Trinity will have the benefits of a letter of credit and a revolving liquidity facility from GE Capital as described in footnote (6).
 - (12) Investment agreement maturing December 1, 2028 with Westdeutsche Landesbank Girozentrale.
 - (13) Offered Veterans G.O. Bonds. Investment agreement maturing December 1, 2001 with Bayerische Landesbank Girozentrale.

Cancellations and Delinquencies

Set forth in the table below is a comparative chart of delinquent, cancelled and repossessed Contracts of Purchase and certain comparative information regarding USDVA guaranteed loans during the same period.

	<u>1994⁽¹⁾</u>	<u>1995⁽¹⁾</u>	<u>1996⁽¹⁾</u>	<u>1997⁽¹⁾</u>	<u>1998⁽¹⁾</u>	<u>1999⁽²⁾</u>
Percentage of Number of Contracts of Purchase						
Delinquent⁽³⁾						
30-67 days.....	0.99%	1.45%	2.90%	1.65%	0.78%	0.87%
68+ days.....	4.24%	3.12%	2.50%	3.22%	1.99%	1.38%
Cancelled Contracts and Bankruptcies⁽⁴⁾	0.38%	0.64%	0.82%	0.94%	0.82%	0.51%
Repossessed Contracts	0.35%	0.64%	1.07%	0.92%	0.67%	0.39%
 USDVA Guaranteed Loans⁽⁵⁾						
Percentages in U.S.						
Delinquent						
30-60 days.....	4.07%	4.14%	4.59%	4.54%	4.45%	4.10%
60+ days.....	2.25%	2.21%	2.20%	2.21%	2.35%	2.29%
Foreclosures in inventory	1.44%	1.26%	1.54%	1.81%	1.77%	1.97%
 Percentages in California						
Delinquent						
30-60 days.....	3.42%	4.03%	4.23%	4.30%	4.28%	4.23%
60+ days.....	2.36%	2.53%	2.36%	2.52%	2.61%	2.75%
Foreclosures in inventory	2.28%	2.31%	3.18%	3.54%	2.92%	2.84%

(1) As of June 18 for Department's and as of June 30 for USDVA data.

(2) As of June 18, 1999 for Department's and as of March 30, 1999 for USDVA data.

(3) Time periods conform to Department's record-keeping system.

(4) Bankruptcies are included in cancelled Contracts statistics and do not exceed in any period more than 10% of total cancellations and bankruptcy category. Federal bankruptcy law precludes repossession action of Contracts of Purchase when veteran is in bankruptcy proceedings until the automatic stay is lifted.

(5) Source: National Delinquency Survey published by the Mortgage Bankers Association of America.

Veterans G.O. Bonds and Revenue Bonds

The chart below sets forth certain information regarding Veterans G.O. Bonds and Revenue Bonds, including those expected to be redeemed as a result of the issuance of the Offered 1999 Veterans G.O. Bonds.

Selected Information with Respect to Veterans G.O. Bonds and Revenue Bonds

Series	Bonds Outstanding as of 06/30/99	Bonds Expected to be Outstanding as of 12/1/99	Final Maturity or Mandatory Tender Date of Series	Next Optional Call Date	Call Price on Such Date	Maximum Coupon Subject to Optional Call	Bond Subject to Special Redemption
Veterans G.O. Bonds Issued Prior to the Mortgage Subsidy Bond Tax Act of 1980							
QQ.....	\$ 4,800,000	\$ 4,800,000	February 1, 2000	Non-Callable	N.A.	N.A.	No
AD.....	42,600,000	42,600,000	April 1, 2005	April 1, 2000	100%	6.800%	No
AE.....	22,720,000	22,720,000	August 1, 2005	August 1, 2000	100%	7.000%	No
AF.....	34,080,000	34,080,000	August 1, 2005	August 1, 2000	100%	7.300%	No
AG.....	49,200,000	42,600,000	October 1, 2005	October 1, 2000	100%	8.250%	No
Sub-total.....	\$ 153,400,000	\$ 146,800,000					
Veterans G.O. Bonds Issued to Refund Bonds Issued Prior to the Mortgage Subsidy Bond Tax Act of 1980							
BM.....	\$ 66,600,000	\$ 66,600,000	December 1, 2025	-- ⁽¹⁾	-- ⁽¹⁾	5.450%	Excess Revenues/Unexpended
BN2-4.....	91,065,000	91,065,000	December 1, 2028	-- ⁽¹⁾	-- ⁽¹⁾	5.450%	Excess Revenues/Unexpended
	\$ 157,665,000	\$ 157,665,000					
Veterans G.O. Bonds Issued as Qualified Veterans Mortgage Bonds under the 1954 Code							
AH.....	\$ 56,000,000	\$ 49,000,000	August 1, 2006	August 1, 2001	100%	10.000%	No
AK.....	12,000,000	12,000,000	April 1, 2007	Non-callable	N.A.	N.A.	No
AL.....	38,000,000	38,000,000	April 1, 2007	Non-callable	N.A.	N.A.	No
AM.....	60,000,000	53,000,000	October 1, 2008	Non-callable	N.A.	N.A.	No
AN/AP.....	90,000,000	90,000,000	April 1, 2009	Non-callable	N.A.	N.A.	No
AQ.....	90,000,000	82,500,000	October 1, 2008	Non-callable	N.A.	N.A.	No
AR.....	43,500,000	37,500,000	October 1, 2009	Non-callable	N.A.	N.A.	No
AS.....	44,000,000	41,500,000	October 1, 2009	Non-callable	N.A.	N.A.	No
AT.....	194,155,000	194,155,000	February 1, 2010	Non-callable	N.A.	N.A.	No
AU.....	130,790,000	122,230,000	October 1, 2010	Non-callable	N.A.	N.A.	No
AV.....	89,665,000	83,670,000	October 1, 2010	Non-callable	N.A.	N.A.	No
Sub-total.....	\$ 848,110,000	\$ 803,555,000					
Veterans G.O. Bonds Issued as Qualified Veterans Mortgage Bonds under the 1986 Code							
BC/BF ⁽²⁾	\$ 320,745,000	\$ 320,745,000	February 1, 2027	December 1, 1999	101%	6.550%	Allocated Prepayments ⁽³⁾
BG/BH.....	586,355,000	586,355,000	December 1, 2032	-- ⁽⁴⁾	-- ⁽⁴⁾	5.600% ⁽⁴⁾	Excess Revenues/Unexpended
BJ3/4.....	100,000,000	40,000,000	June 1, 2000	N.A.	100%	3.200%	Unexpended
BJ5/6.....	171,500,000	171,500,000	June 1, 2001	June 1, 2000	100%	3.600%	Unexpended
BJ7/8 ⁽⁵⁾	--	60,000,000	December 1, 2032	December 1, 2005	102%	6.200%	Excess Revenues/Unexpended
BK/BL.....	255,615,000	255,615,000	December 1, 2012	-- ⁽⁴⁾	-- ⁽⁴⁾	5.300% ⁽⁴⁾	Excess Revenues/Unexpended
BP/BN1 ⁽¹⁾	14,000,000	14,000,000	December 1, 2026	-- ⁽¹⁾	-- ⁽¹⁾	5.500% ⁽¹⁾	Excess Revenues/Unexpended
BQ/BR.....	80,000,000	80,000,000	December 1, 2029	June 1, 2004	101%	5.300%	Excess Revenues/Unexpended
Sub-total.....	\$ 1,528,215,000	\$ 1,528,215,000					
TOTAL VETERANS	\$ 2,687,390,000	\$ 2,636,235,000					
G.O. BONDS.....							

Series	Bonds Outstanding as of 6/30/99	Bonds Expected to be Outstanding as of 12/1/99	Final Maturity or Mandatory Tender Date of Series	Next Optional Call Date	Call Price on Such Date	Maximum Coupon Subject to Optional Call	Bond Subject to Special Redemption
1997 A/B	\$ 20,755,000	\$ 20,500,000	December 1, 2028	December 1, 2008	101%	5.500%	Excess Revenues/Unexpended
1997 C	100,000,000	100,000,000	December 1, 2001	August 1, 2000	100%	3.650%	Unexpended
1998 A	143,205,000	134,900,000	December 1, 2019	December 1, 2008	101%	5.450%	Excess Revenues/Unexpended
Sub-total	\$ 263,960,000	\$ 255,400,000					
Revenue Bonds Issued to Refund Bonds Issued Prior to Mortgage Subsidy Bond Tax Act of 1980							
1999 A	\$ 54,170,000	\$ 54,170,000	December 1, 2027	June 1, 2004	101%	5.200%	Excess Revenues/Unexpended
1999 B	86,085,000	86,085,000	December 1, 2028	June 1, 2004	101%	5.200%	Excess Revenues/Unexpended
Sub-total	\$ 140,255,000	\$ 140,255,000					
TOTAL REVENUE BONDS	\$ 404,215,000	\$ 395,655,000					
TOTAL ALL BONDS	\$ 3,091,605,000	\$ 3,031,890,000					

- (1) The Series BM Bonds and Series BN Bonds maturing on and before December 1, 2004 are subject to optional redemption at par on and after June 1, 2000. The remaining Series BM Bonds and Series BN Bonds and all of the Series BP Bonds are subject to optional redemption on and after December 1, 2003, initially at 101% of the principal amount thereof, declining to par on and after December 1, 2004.
- (2) Includes Series BC, Series BD, Series BE and Series BF. (Series BC/BF)
- (3) Subject to redemption at par from a portion of prepayments on all Contracts of Purchase as allocated to Series based on periodically determined ratio of outstanding bonds (including Veterans G.O. Bonds and Revenue Bonds) of Series to all outstanding bonds. Series BC/BF are subject to optional redemption at par on and after December 1, 1999.
- (4) Except as described in the next sentence, the Series BG Bonds, Series BH Bonds, and Series BL Bonds are subject to optional redemption on and after December 1, 2008, initially at 101% of the principal amount thereof, declining to par on December 1, 2009. The Series BH Bonds maturing on December 1, 2018, December 1, 2024, and December 1, 2032 are subject to optional redemption on and after December 1, 2003 at 102% of the principal amount thereof, declining to 101% of the principal amount thereof on and after December 1, 2004, and declining further to par on December 1, 2005. The Series BK Bonds are not subject to optional redemption.
- (5) Offered Veterans G.O. Bonds.

Additional Investments

In addition to the investments described above under "Contracts of Purchase--Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments," the following investments have been made or will be made with respect to moneys in the 1943 Fund and the Bond Reserve Account which secures the Revenue Bonds:

<u>Fund or Account Designation⁽¹⁾</u>	<u>Amount</u>	<u>Type of Investment</u>	<u>Investment Provider</u>	<u>Investment Maturity Date</u>	<u>Investment (%)</u>
1997/1998 Bond Reserve Subaccount.....	\$5,251,650	investment agreement	Societe Generale ⁽³⁾	12/1/28	5.75
	\$7,001,992 ⁽²⁾	U.S. Treasury Bond	N.A.	5/15/05	6.50
1999 Bond Reserve Subaccount.....	\$9,817,850	investment agreement	Westdeutsche Landesbank Girozentrale	12/1/28	5.38
1997/1998 Revenue Bond Series Revenue Subaccount and 1997/1998 Revenue Bond Series Restricted Recoveries Subaccount.....	variable	investment agreement	Societe Generale ⁽³⁾	12/1/28	5.91
BG, BH, BK, BL G.O. Bond Series Revenue Subaccount and BG, BH, BK, BL G.O. Bonds Series Recycling Subaccount.....	variable ⁽⁴⁾	investment agreement	Societe Generale ⁽³⁾	12/1/32	5.91
BM, BN G.O. Bond Series Revenue Subaccount.....	variable	investment agreement	Westdeutsche Landesbank Girozentrale	12/1/28	5.38
BM, BN G.O. Bond Series Recycling Subaccount.....	variable ⁽⁵⁾	investment agreement	Westdeutsche Landesbank Girozentrale	12/1/28	5.38
BP G.O. Bond Series Revenue Subaccount.....	variable	investment agreement	Westdeutsche Landesbank Girozentrale	12/1/28	5.38
BP G.O. Bond Series Recycling Subaccount.....	variable ⁽⁵⁾	investment agreement	Westdeutsche Landesbank Girozentrale	12/1/28	5.38
1999 A/B Revenue Bond Series Revenue Subaccount and 1999 A/B Revenue Bond Series Recycling Subaccount.....	variable ⁽⁶⁾	investment agreement	Bayerische Landesbank Girozentrale	12/1/28	5.30
BQ/BR G.O. Bond Series Revenue Subaccount and BQ/BR G.O. Bond Series Recycling Subaccount ⁽⁷⁾	variable ⁽⁷⁾	investment agreement	Westdeutsche Landesbank Girozentrale	12/1/29 ⁽⁷⁾	5.37
BJ 7/8 G.O. Bond Series Revenue Subaccount and BJ 7/8 G.O. Bond Series Recycling Subaccount ⁽⁸⁾	variable ⁽⁸⁾	investment agreement	N.A.	12/1/32	N.A.

(1) Accounts are established in the resolutions authorizing the issuance of Revenue Bonds.

(2) At cost.

(3) On February 1, 1999, Moody's announced that it had placed under review for possible downgrade certain ratings of Societe Generale, including its long-term ratings (senior debts and deposits, currently rated at Aa3 by Moody's) and its bank financial strength rating (currently rated at B by Moody's).

(4) Maximum permitted amount on deposit under investment agreement at any one time is \$250,000,000.

(5) Maximum permitted amount on deposit under investment agreement for both accounts is \$50,000,000.

(6) Maximum permitted amount on deposit under investment agreement for both accounts is \$75,000,000.

(7) Maximum permitted amount on deposit under investment agreement for both accounts is \$35,000,000.

(8) Expected investment with respect to the Series BJ 7/8 Bonds.

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APPENDIX C

BOOK-ENTRY SYSTEM

The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that the State Treasurer believes to be reliable, but the Treasurer takes no responsibility for the accuracy thereof. All capitalized terms used and not otherwise defined in this APPENDIX C shall have the meanings set forth in the front portion of this Official Statement.

DTC will act as securities depository for the Offered Veterans G.O. Bonds. The Offered Veterans G.O. Bonds will, when issued, be registered in the name of Cede & Co. (DTC's partnership nominee). One or more fully registered Offered Veterans G.O. Bonds will be issued for each maturity of Offered Veterans G.O. Bonds and will be deposited with DTC.

DTC is a limited-purpose trust company organized under the laws of the State of New York, a "banking organization" within the meaning of the laws of the State of New York, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934, as amended; DTC holds securities that its participants ("DTC Participants") deposit with DTC. DTC also facilitates the settlement among DTC Participants of securities transactions, such as transfers and pledges, in deposited securities through electronic computerized book-entry changes in accounts of DTC Participants, thereby eliminating the need for physical movement of securities certificates. DTC Participants include securities brokers and dealers, banks, trust companies, clearing corporations and certain other organizations (the "Direct Participants"). DTC is owned by a number of its Direct Participants and by the New York Stock Exchange, Inc., the American Stock Exchange, Inc., and the National Association of Securities Dealers, Inc. Access to the DTC book-entry system is also available to others such as banks, securities brokers and dealers and trust companies that clear through or maintain a custodial relationship with a DTC Participant, either directly or indirectly (the "Indirect Participants"). The rules applicable to DTC and its Direct Participants and Indirect Participants are on file with the Securities and Exchange Commission.

Purchases of the Offered Veterans G.O. Bonds under the DTC System must be made by or through Direct Participants, which will receive a credit balance in the records of DTC. The ownership interest of each actual purchaser of each Offered Veterans G.O. Bond ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase, but Beneficial Owners are expected to receive written confirmation providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Offered Veterans G.O. Bonds will be accomplished by book entries made by DTC and, in turn, by the DTC Participants who act on behalf of the Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interest in the Offered Veterans G.O. Bonds, except in the event that use of the book-entry system for the Offered Veterans G.O. Bonds is discontinued.

To facilitate subsequent transfers, all of the Offered Veterans G.O. Bonds deposited by Direct Participants with DTC are endorsed in the name of DTC's partnership nominee, Cede & Co. The deposit of the Offered Veterans G.O. Bonds with DTC and their endorsement in the name of Cede & Co. effect no change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Offered Veterans G.O. Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Offered Veterans G.O. Bonds are credited, which may or may not be the Beneficial Owners. The DTC Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to statutory or regulatory requirements as may be in effect from time to time. The State Treasurer will not have any responsibility or obligation to such DTC Participants or the persons for whom they act as nominees with respect to the Offered Veterans G.O. Bonds.

Redemption notices will be sent to Cede & Co. If less than all of the Offered Veterans G.O. Bonds having the same maturity date(s) are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such Offered Veterans G.O. Bonds to be redeemed.

The principal, premium and interest payments on the Offered Veterans G.O. Bonds will be made to DTC. DTC's practice is to immediately credit the accounts of the DTC Participants in accordance with their respective holdings shown on the records of DTC unless DTC has reason to believe that it will not receive payment on the payment date. Payments by DTC Participants and Indirect Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is now the case with securities held for the accounts of customers in bearer form or registered in "street name" and will be the responsibility of such DTC Participant or Indirect Participant and not of DTC or the Treasurer, subject to statutory and regulatory requirements as may be in effect from time to time. Payment of principal and interest to DTC is the responsibility of the Treasurer, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as a securities depository with respect to the Offered Veterans G.O. Bonds at any time by giving reasonable notice to the Treasurer. Under such circumstances, in the event that a successor securities depository is not obtained, physical certificates are required to be printed and delivered.

The Treasurer may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, physical certificates will be printed and delivered.

SO LONG AS CEDE & CO. IS THE REGISTERED OWNER OF THE OFFERED VETERANS G.O. BONDS, AS NOMINEE OF DTC, REFERENCES HEREIN TO THE OWNERS OF OFFERED VETERANS G.O. BONDS SHALL MEAN CEDE & CO., AS

AFORESAID, AND SHALL NOT MEAN THE BENEFICIAL OWNERS OF THE OFFERED VETERANS G.O. BONDS.

NEITHER THE STATE NOR THE TREASURER WILL HAVE ANY RESPONSIBILITY OR OBLIGATION TO DIRECT PARTICIPANTS, INDIRECT PARTICIPANTS, OR TO ANY BENEFICIAL OWNER WITH RESPECT TO (i) THE ACCURACY OF ANY RECORDS MAINTAINED BY DTC, ANY DIRECT PARTICIPANT, OR INDIRECT PARTICIPANT; (ii) THE DELIVERY OF ANY NOTICE THAT IS PERMITTED OR REQUIRED TO BE GIVEN TO THE OWNERS OF THE OFFERED VETERANS G.O. BONDS; (iii) THE PAYMENT BY DTC OR ANY DIRECT PARTICIPANT OR INDIRECT PARTICIPANT OF ANY AMOUNT WITH RESPECT TO THE PRINCIPAL OR INTEREST DUE WITH RESPECT TO THE OFFERED VETERANS G.O. BONDS; (iv) ANY CONSENT GIVEN OR OTHER ACTION TAKEN BY DTC AS THE REGISTERED OWNER OR OFFERED VETERANS G.O. BONDS; OR (v) ANY OTHER MATTER.

DTC's Year 2000 Efforts

DTC management is aware that some computer applications, systems, and the like for processing data ("Systems") that are dependent upon calendar dates, including dates before, on, and after January 1, 2000, may encounter "Year 2000 problems." DTC has informed its participants and other members of the financial community (the "Industry") that it has developed and is implementing a program so that its Systems, as the same relate to the timely payment of distributions (including principal and interest payments) to securityholders, book-entry deliveries, and settlement of trades within DTC ("DTC Services"), continue to function appropriately. This program includes a technical assessment and a remediation plan, each of which is complete. Additionally, DTC's plan includes a testing phase, which is expected to be completed within appropriate time frames.

However, DTC's ability to perform properly its services is also dependent upon other parties, including but not limited to issuers and their agents, as well as third party vendors from whom DTC licenses software and hardware, and third party vendors on whom DTC relies for information or the provision of services, including telecommunication and electrical utility service providers, among others. DTC has informed the Industry that it is contacting (and will continue to contact) third party vendors from whom DTC acquires services to: (i) impress upon them the importance of such services being Year 2000 compliant; and (ii) determine the extent of their efforts for Year 2000 remediation (and, as appropriate, testing) of their services. In addition, DTC is in the process of developing such contingency plans as it deems appropriate.

According to DTC, the foregoing information with respect to DTC's Year 2000 efforts has been provided to the Industry for informational purposes only and is not intended to serve as a representation, warranty, or contract modification of any kind.

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APPENDIX D

SUMMARY OF CONTINUING DISCLOSURE CERTIFICATES

STATE TREASURER'S DISCLOSURE CERTIFICATE

The State Treasurer, on behalf of the State, executed a Continuing Disclosure Certificate (the "Treasurer's Disclosure Certificate") for the Offered Veterans G.O. Bonds at the time of delivery of the Offered Veterans G.O. Bonds to the purchasers thereof. The following is a summary of the provisions of the Treasurer's Disclosure Certificate. The summary is qualified by reference to the complete Treasurer's Disclosure Certificate, which is available from the Office of the State Treasurer.

Definitions

Pursuant to the Treasurer's Disclosure Certificate, the following definitions will apply:

"Annual Report" shall mean the Annual Report filed by the State Treasurer pursuant to, and as described in, the Treasurer's Disclosure Certificate.

"Beneficial Owner" shall mean any person which has or shares the power, directly or indirectly, to make investment decisions concerning ownership of any applicable Offered Veterans G.O. Bonds (including persons holding applicable Offered Veterans G.O. Bonds through nominees, depositories or other intermediaries).

"Dissemination Agent" shall mean the State Treasurer, acting in its capacity as Dissemination Agent under the Treasurer's Disclosure Certificate, or any successor Dissemination Agent designated in writing by the State Treasurer.

"Holder" shall mean any person listed on the registration books of the State Treasurer as the registered owner of any applicable Offered Veterans G.O. Bonds.

"Listed Events" shall mean any of the events listed below under "Reporting of Significant Events."

"National Repository" shall mean any Nationally Recognized Municipal Securities Information Repository certified by the Securities and Exchange Commission to be the recipient of information of the nature of the Annual Reports required by the Treasurer's Disclosure Certificate.

"Official Statement" shall mean the Official Statement relating to the original issuance of the Offered Veterans G.O. Bonds.

"Repository" shall mean each National Repository and the State Repository.

"Rule" shall mean Rule 15c2-12(b)(5) adopted by the Securities and Exchange Commission under the Securities Exchange Act of 1934, as the same may be amended from time to time.

"State" shall mean the State of California.

"State Repository" shall mean any public or private repository or entity within the State created for the purpose of receiving information of the nature of the Annual Reports or reports of material events required by the Treasurer's Disclosure Certificate and recognized as such by the Securities and Exchange Commission. As of the date of this Official Statement, there is no State Repository.

Annual Reports

The State Treasurer on behalf of the State shall, not later than April 1 of each year in which the applicable Offered Veterans G.O. Bonds are outstanding, commencing with the report for the 1998-99 Fiscal Year, provide an Annual Report consistent with the requirements of the applicable Treasurer's Disclosure Certificate (an "Annual Report") to each Repository; provided that the audited financial statements of the State may be submitted separately from the balance of the Annual Report and later than the date required above for the filing of the Annual Report if they are not available by that date. The State Treasurer shall make a copy of any Annual Report available to any person who requests a copy at a cost not exceeding the reasonable cost of duplication and delivery.

If in any year, the State Treasurer does not provide the Annual Report to each Repository by the time specified above, the State Treasurer shall instead file a notice with each Repository stating that the Annual Report has not been timely completed and, if known, stating the date by which the State Treasurer expects to file the Annual Report.

The Annual Report shall contain or include by reference the following:

(1) The audited General Purpose Financial Statements of the State for the fiscal year ended on the previous June 30, prepared in accordance with generally accepted accounting principles promulgated to apply to government entities from time to time by the Governmental Accounting Standards Board. If the State's audited financial statements are not available by the time the Annual Report is required to be filed pursuant to the Treasurer's Disclosure Certificate, the Annual Report shall contain unaudited financial statements in a format similar to the financial statements contained in the applicable final Official Statement, and the audited financial statements shall be filed in the same manner as the Annual Report when they become available.

(2) Financial information relating to the State's General Fund budget for the fiscal year ended on the previous June 30 and information concerning the State budget for the fiscal year in which the Annual Report is issued. Such information shall describe the sources of revenues, the principal categories of expenditures, and changes in fund balances, a summary of expected State revenues and budgeted expenditures, and significant assumptions relating to revenue and expenditure expectations, including updating the following tables which appear under the caption

APPENDIX A—"THE STATE OF CALIFORNIA—Current State Budget" in the applicable Official Statement:

Table Entitled

**Summary of State Revenues and Expenditures
Revenue and Expenditure Assumptions**

(3) Information concerning the total amount of the State's authorized and outstanding debt, long-term lease obligations and other long-term liabilities as of the end of the most recent June 30, which debt is supported by payments from the State's General Fund and which includes short-term debt. Such information shall include schedules of debt service for outstanding general obligation bonds and lease-purchase debt. This shall be accomplished by updating the following tables which appear under the caption APPENDIX A—"THE STATE OF CALIFORNIA—State Indebtedness" in the Official Statement.

Table Entitled

**Authorized and Outstanding General Obligation Bonds
Outstanding State Debt**

**Schedule of Debt Service Requirements for General Fund
General Obligation Bonds**

**Schedule of Debt Service Requirements for
Enterprise Fund General Obligation Bonds**

**Schedule of Debt Service Requirements for
Lease-Purchase Debt**

**State Public Works Board and
Other Lease-Purchase Financing**

**State Agency Revenue Bonds and
Conduit Financing**

The Annual Report may consist of one or more documents. Any or all of the items listed above may be included in the Annual Report by reference to other documents which have been filed by the State with each of the Repositories, including any final official statement (in which case such final official statement must also be available from the Municipal Securities Rulemaking Board). The State Treasurer shall clearly identify in the Annual Report each such document so included by reference.

Reporting of Significant Events

The State Treasurer, on behalf of the State shall give, or cause to be given, prompt notice of the occurrence of any of the following events with respect to the applicable Offered Veterans G.O. Bonds (hereafter referred to as a "Listed Event"), if material:

1. principal and interest payment delinquencies;
2. non-payment related defaults;
3. modifications to rights of Bondholders;
4. optional, contingent or unscheduled bond calls;
5. defeasances;
6. rating changes;
7. adverse tax opinions or event affecting the tax-exempt status of the applicable Offered Veterans G.O. Bonds;
8. unscheduled draws on debt service reserves reflecting financial difficulties;
9. unscheduled draws on credit enhancements reflecting financial difficulties;
10. substitution of credit or liquidity providers, or their failure to perform; or
11. release, substitution or sale of property securing repayment of the applicable Offered Veterans G.O. Bonds.

The State Treasurer shall timely file a notice of each such occurrence, if it is material under applicable federal securities laws, with the Municipal Securities Rulemaking Board and each Repository. The State notes that items 8, 9, 10, and 11 above are not applicable to the Offered Veterans G.O. Bonds.

Other Provisions

Termination of Reporting Obligation. The State's obligations under the Treasurer's Disclosure Certificate shall terminate upon the maturity, legal defeasance, prior redemption or acceleration of all of the applicable outstanding Offered Veterans G.O. Bonds.

Dissemination Agent. The State Treasurer may, from time to time, appoint or engage a Dissemination Agent to assist it in carrying out the obligations under the Treasurer's Disclosure Certificate, and may discharge any such Dissemination Agent, with or without appointing a successor Dissemination Agent. If at any time there is not any other designated Dissemination Agent, the State Treasurer shall be the Dissemination Agent. The initial Dissemination Agent shall be the State Treasurer.

Amendment; Waiver. Notwithstanding any other provision of a Treasurer's Disclosure Certificate, the State Treasurer may amend or waive any provision of the Treasurer's Disclosure Certificate, provided that the following conditions are satisfied:

(a) If the amendment or waiver relates to the provisions of the Treasurer's Disclosure Certificate dealing with the timing or content of the Annual Report or the giving of notice of Listed Events, it may only be made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature or status

of an obligated person with respect to the applicable Offered Veterans G.O. Bonds, or the type of business conducted;

(b) The undertaking, as amended or taking into account such waiver, would, in the opinion of nationally recognized bond counsel, have complied with the requirements of the Rule at the time of the original issuance of the applicable Offered Veterans G.O. Bonds, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and

(c) The amendment or waiver either (i) is approved by the Holders of 60 percent of the Bonds, or (ii) does not, in the opinion of nationally recognized bond counsel, materially impair the interests of the Holders or Beneficial Owners of the applicable Offered Veterans G.O. Bonds.

Additional Information. Nothing in either Treasurer's Disclosure Certificate shall be deemed to prevent the State Treasurer from disseminating any other information, using the means of dissemination set forth in the Treasurer's Disclosure Certificate or any other means of communication, or including any other information in any Annual Report or notice of occurrence of a Listed Event, in addition to that which is required by the Treasurer's Disclosure Certificate. If the State Treasurer chooses to include any information in any Annual Report or notice of occurrence of a Listed Event in addition to that which is specifically required by the Treasurer's Disclosure Certificate, the State Treasurer shall not have any obligation to update such information or include it in any future Annual Report or notice of occurrence of a Listed Event.

Beneficiaries. The Treasurer's Disclosure Certificate shall inure solely to the benefit of the Holders and Beneficial Owners from time to time of the applicable Offered Veterans G.O. Bonds, and shall create no rights in any other person or entity (except the right of any Bondholder or Beneficial Owner to enforce the provisions of the Treasurer's Disclosure Certificate on behalf of the Bondholders). The Treasurer's Disclosure Certificate is not intended to create any monetary rights on behalf of any person based upon the Rule.

DEPARTMENT'S DISCLOSURE CERTIFICATE

The Secretary of Veterans Affairs (the "Secretary"), on behalf of the Department, executed a Continuing Disclosure Certificate (the "Department's Disclosure Certificate") for the Offered Veterans G.O. Bonds at the time of delivery of the Offered Veterans G.O. Bonds to the purchasers thereof. The following is a summary of the Department's Disclosure Certificate. Such summary is qualified by reference to the complete Department's Disclosure Certificate, which is available from the Department.

Certain Definitions

Defined terms used in the Department's Disclosure Certificate and not otherwise defined therein have the meanings set forth elsewhere in this Official Statement.

"Beneficial Owner" means a Beneficial Owner of Subject Bonds, as determined pursuant to the Rule.

"Bondowners" means the registered owners of the Subject Bonds.

"Bonds" means, at any time, all of the State's then Outstanding Offered Veterans G.O. Bonds, collectively.

"Fiscal Year" means that period established by the Department with respect to which its, as applicable, Audited Financial Statements or Unaudited Financial Statements are prepared. As of the date of the Department's Disclosure Certificate, the Department's Fiscal Year begins on July 1 and ends on June 30 of the next calendar year.

"MSRB" means the Municipal Securities Rulemaking Board established pursuant to Section 15B(b)(1) of the Securities Exchange Act of 1934.

"Notice" means written notice, sent for overnight delivery via the United States Postal Service or a private delivery service which provides evidence of delivery.

"Notice Address" means with respect to the Department:

State of California Department of Veterans Affairs
1227 O Street
Sacramento, CA 95814
Attention: Bond Finance Division

"NRMSIR" means, at any time, a then-existing nationally recognized municipal securities information repository, as recognized from time to time by the SEC for the purposes referred to in the Rule.

"Official Statement" means the Official Statement relating to the original issuance of the Offered Veterans G.O. Bonds.

"Participating Underwriter" means any of the original underwriters of any Subject Bonds required to comply with the Rule in connection with the offering of such Subject Bonds.

"Rule" means the applicable provisions of Rule 15c2-12 promulgated by the SEC under the Securities Exchange Act of 1934, as amended (17 CFR Part 240, § 240.15c2-12), as in effect on the date of the Department's Disclosure Certificate, including any official interpretations thereof.

"SEC" means the United States Securities and Exchange Commission.

"Securities Counsel" means legal counsel expert in Federal securities laws.

"SID" means, at any time, a then-existing state information depository, if any, as operated or designated as such by or on behalf of the State and recognized by the SEC for the purposes referred to in the Rule.*

"Subject Bonds" means the Offered Veterans G.O. Bonds and those Veterans G.O. Bonds subject to the same Department's Disclosure Certificate.

Provision of Annual Financial Information

The Department will, not later than the first day of the tenth calendar month after the end of each of the Department's Fiscal Years, commencing with the report for the 1998-1999 Fiscal Year, provide to the State Treasurer and to each NRMSIR and the SID the Annual Financial Information. The audited financial statements of the Department may be submitted separately from the balance of the Annual Financial Information, and later than the date required for the filing of the Annual Financial Information if not available by that date.

The Department's Disclosure Certificate requires the Department to provide, in a timely manner, notice of any failure by it to provide Annual Financial Information to each NRMSIR and the SID on or before the date described in the first paragraph under this heading, to the SID, to the State Treasurer, and to either (i) each NRMSIR or (ii) the MSRB.

Content of Annual Financial Information

The Department's Annual Financial Information shall contain or include by reference the following:

- (a) the audited financial statements of the 1943 Fund for the Fiscal Year ended on the previous June 30, prepared in accordance with generally accepted accounting principles established by the Financial Accounting Standards Board, if available, or unaudited financial statements for such Fiscal Year; and

* As of the date of this Official Statement, there is no SID.

(b) financial information or operating data of the types included in Exhibit 2 to APPENDIX B of the Official Statement entitled "Certain Department Financial Information and Operating Data."

If not provided as part of the Annual Financial Information by the date required (as described above under "Provision of Annual Financial Information"), the Department shall provide audited financial statements, when and if available, to the State Treasurer and to each NRMSIR and the SID.

Any or all of the items listed above may be included by specific reference to other documents, including official statements of debt issues of the Department or related public entities, which have been submitted to each NRMSIR and the SID or the SEC. (If such document is an official statement, it must also be available from the MSRB.) Annual Financial Information may be provided in one document or multiple documents, and at one time or in part from time to time.

Additional Information

Nothing in the Department's Disclosure Certificate will be deemed to prevent the Department from disseminating any other information, using the means of dissemination set forth in such Department's Disclosure Certificate or any other means of communication, or including any other information in any Annual Financial Information, in addition to that which is required by the Department's Disclosure Certificate. If the Department chooses to include any information in any Annual Financial Information in addition to that which is specifically required by the Department's Disclosure Certificate, the Department will have no obligation under the Department's Disclosure Certificate to update such information or include it in any future Annual Financial Information.

Amendment of Department's Disclosure Certificate

The Department's Disclosure Certificate may be amended and any provision of the Department's Disclosure Certificate be waived, without the consent of the Bondowners or Beneficial Owners, except as described in clause 4(ii) below, under the following conditions: (1) such amendment or waiver is made in connection with a change in circumstances that arises from a change in legal (including regulatory) requirements, a change in law (including rules or regulations) or in interpretations thereof, or a change in the identity, nature, or status of the Department or the type of business conducted thereby, (2) the Department's Disclosure Certificate as so amended or waived would have complied with the requirements of the Rule as of the date of each primary offering of Subject Bonds affected by such amendment or waiver, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances, (3) the Department shall have obtained an opinion of Securities Counsel, addressed to the Department and the State Treasurer, to the same effect as set forth in clause (2) above, (4) either (i) a party unaffiliated with the Department (such as bond counsel), acceptable to the Department, has determined that the amendment or waiver does not materially impair the interests of the Beneficial Owners, or (ii) the applicable Bondowners consent to the amendment to or waiver of such Department's Disclosure Certificate, and (5) the Department shall have

delivered copies of such amendment or waiver to the SID, to the State Treasurer, and to either each NRMSIR or the MSRB.

In addition to the foregoing, the Department may amend the Department's Disclosure Certificate, and any provision of the Department's Disclosure Certificate may be waived, if the Department shall have received an opinion of Securities Counsel, addressed to the Department and the State Treasurer, to the effect that the adoption and the terms of the amendment or waiver would not, in and of themselves, cause the undertakings in such Department's Disclosure Certificate to violate the Rule, taking into account any subsequent change in or official interpretation of the Rule.

Benefit; Enforcement

The provisions of the Department's Disclosure Certificate will inure solely to the benefit of the bondowners and Beneficial Owners from time to time.

Except as described in this paragraph, the provisions of the Department's Disclosure Certificate will create no rights in any other person or entity. The obligation of the Department to comply with the provisions of the Department's Disclosure Certificate are enforceable (i) in the case of enforcement of obligations to provide financial statements, financial information, operating data, and notices, by any Beneficial Owner of Outstanding Subject Bonds, or (ii) in the case of challenges to the adequacy of the financial statements, financial information, and operating data so provided, by the Bondowners of not less than 20% in aggregate principal amount of the Subject Bonds at the time Outstanding.

The right to enforce the provisions of the Department's Disclosure Certificate is limited to a right, by action in mandamus or for specific performance, to compel performance of the Department's obligations under the Department's Disclosure Certificate. Any failure by the Department to perform in accordance with the Department's Disclosure Certificate will not constitute a default or an Event of Default under the Subject Bonds, and the rights and remedies provided by the Subject Bonds upon the occurrence of a default or an Event of Default will not apply to any such failure.

Termination of Reporting Obligation

The Department's obligations under the Department's Disclosure Certificate with respect to the Subject Bonds terminate upon the legal defeasance, prior redemption, or payment in full of all of such Subject Bonds. The Department shall give notice of any such termination to the SID and to either each NRMSIR or the MSRB.

The Department's Disclosure Certificate, or any provision thereof, will be null and void to the extent set forth on the opinion of Securities Counsel obtained by the Department and addressed to the Department and the State Treasurer, to the effect that those portions of the Rule which require the provisions of such Department's Disclosure Certificate, or any of such provisions, do not or no longer apply to the applicable Subject Bonds, whether because such portions of the Rule are invalid, have been repealed, or otherwise, as will be specified in such opinion,

and the Department delivers notice to such effect to the State Treasurer, to the SID and to either each NRMSIR or the MSRB.

Governing Law

The Department's Disclosure Certificate will be construed and interpreted in accordance with the laws of the State, and any suits and actions arising out of the Department's Disclosure Certificate will be instituted in a court of competent jurisdiction in the State, *provided that*, to the extent such Department's Disclosure Certificate addresses matters of Federal securities laws, including the Rule, the Department's Disclosure Certificate will be construed in accordance with such federal securities laws and official interpretations thereof.

APPENDIX E

PROPOSED FORM OF LEGAL OPINION

Bill Lockyer
Attorney General
STATE OF CALIFORNIA
1300 I Street, Suite 1101
Sacramento, California 95814

Hawkins, Delafield & Wood
633 West Fifth Street
Los Angeles, California 90071

(Remarketing Date)

Office of the Treasurer of the State
of California
Sacramento, California

Ladies and Gentlemen:

We have acted as Attorney General of the State of California and as bond counsel to the State of California, respectively, and in such capacities we have examined upon request copies of proceedings taken by the State of California (the "State") in connection with the remarketing of the State's Veterans General Obligation Bonds, Series BJ in the aggregate principal amount of \$60,000,000 (the "Bonds") and the sale of the Bonds to the initial purchasers thereof. The Bonds are issued pursuant to (i) the Veterans Bond Acts identified in Schedule A hereto (collectively, the "Law"), which is incorporated by reference, each of which was approved by the electors of the State, (ii) Part 3 of Division 4 of Title 2 of the California Government Code, and (iii) resolutions (the "Resolutions") adopted by the Veterans Finance Committee of 1943 on November 24, 1997 and December 22, 1997.

The Bonds are dated, mature on the dates in the principal amounts, bear interest, if any, and are payable as provided in the Resolutions. The Bonds are subject to redemption prior to maturity in whole or in part as set forth in the Resolutions.

In addition to the Series BJ Bonds, the State has previously issued its Veterans General Obligation Bonds, Series BG, Series BH, Series BK and Series BL and the Department of Veterans Affairs of the State of California (the "Department") has previously issued its Home Purchase Revenue Bonds, 1997 Series A, 1997 Series B, 1997 Series C and 1998 Series A (collectively, the "1997 Tax Plan Bonds"). The 1997 Tax Plan Bonds are treated as a single issue for certain federal tax purposes under the Internal Revenue Code of 1986, as amended (the "Tax Code"). Applicable federal tax law establishes certain requirements that must be met subsequent to the issuance of the 1997 Tax Plan Bonds (including the Bonds) in order that

interest on the Bonds not be included in gross income for federal income tax purposes under the Tax Code. The Department has adopted documents with respect to its program (the "Program Documents") that establish procedures under which, if followed, such requirements can be met. The State and the Department have covenanted in the Resolutions and in tax certificates and other documents applicable to the issuance of the Bonds (collectively with the Program Documents, the "Documents"), to all times perform all acts and things permitted by law and necessary and desirable in order to assure that interest paid on the Bonds shall not be included in gross income for federal income tax purposes under the Tax Code. In rendering this opinion, we have relied upon such covenants and have assumed compliance by the State and the Department with the provisions of such Documents.

In connection with the issuance and remarketing of the Bonds, we have examined (a) a copy of the Resolutions, and (b) such other opinions, documents, certificates and letters as we deem relevant and necessary in rendering this opinion.

From such examination, we are of the opinion that:

i) The State has lawful authority for the issuance of the Bonds, and the Bonds constitute the valid and legally binding general obligations of the State payable in accordance with the Law from the General Fund of the State. The full faith and credit of the State of California is pledged for the punctual payment of the principal of and interest on the Bonds.

ii) Under existing statutes and court decisions, (a) interest on the Bonds is not included in gross income for federal income tax purposes pursuant to Section 103 of the Tax Code, and (b) interest on the Bonds is a specific preference item for purposes of calculating the federal individual or corporate alternative minimum taxes. The remarketing of the Bonds does not, in and of itself, adversely affect the exclusion of interest on the Bonds from gross income for federal income tax purposes. No opinion as to the exclusion from gross income of interest on any of the Bonds is expressed subsequent to any date on which action is taken pursuant to the Documents for which action the Documents require a legal opinion to the effect that taking such action will not adversely affect such exclusion, should the undersigned not deliver an opinion as of such date to such effect.

iii) Interest on the Bonds is exempt from State personal income taxation under present State law.

In rendering this opinion, we are advising you that the enforceability of the Bonds may be limited by bankruptcy, moratorium, insolvency, or other laws affecting creditors' rights or remedies and is subject to general principles of equity (regardless of whether such enforceability is considered in a proceeding in equity or at law).

We have examined an executed Bond and, in our opinion, the form of said Bond and its execution are regular and proper.

Very truly yours,

BILL LOCKYER,
ATTORNEY GENERAL

[HAWKINS, DELAFIELD & WOOD]

By: _____
Deputy Attorney General

Schedule A

1. \$13,920,000 principal amount of Veterans Bonds, Series BJ7, authorized under Veterans Bond Act of 1988.
2. \$46,080,000 principal amount of Veterans Bonds, Series BJ8, authorized under the Veterans Bond Act of 1990.

APPENDIX F

MUNICIPAL BOND INSURANCE POLICY

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Municipal Bond Insurance Policy

Ambac Assurance Corporation
c/o CT Corporation Systems
44 East Mifflin Street, Madison, Wisconsin 53703
Administrative Office:
One State Street Plaza, New York, New York 10004
Telephone: (212) 668-0340

Issuer:

Policy Number:

Bonds:

Premium:

Ambac Assurance Corporation (Ambac) A Wisconsin Stock Insurance Company

in consideration of the payment of the premium and subject to the terms of this Policy, hereby agrees to pay to United States Trust Company of New York, as trustee, or its successor (the "Insurance Trustee"), for the benefit of Bondholders, that portion of the principal of and interest on the above-described debt obligations (the "Bonds") which shall become Due for Payment but shall be unpaid by reason of Nonpayment by the Issuer.

Ambac will make such payments to the Insurance Trustee within one (1) business day following notification to Ambac of Nonpayment. Upon a Bondholder's presentation and surrender to the Insurance Trustee of such unpaid Bonds or appurtenant coupons, uncanceled and in bearer form and free of any adverse claim, the Insurance Trustee will disburse to the Bondholder the face amount of principal and interest which is then Due for Payment but is unpaid. Upon such disbursement, Ambac shall become the owner of the surrendered Bonds and coupons and shall be fully subrogated to all of the Bondholder's right to payment.

In cases where the Bonds are issuable only in a form whereby principal is payable to registered Bondholders or their assigns, the Insurance Trustee shall disburse principal to a Bondholder as aforesaid only upon presentation and surrender to the Insurance Trustee of the unpaid Bond, uncanceled and free of any adverse claim, together with an instrument of assignment, in form satisfactory to the Insurance Trustee, duly executed by the Bondholder or such Bondholder's duly authorized representative, so as to permit ownership of such Bond to be registered in the name of Ambac or its nominee. In cases where the Bonds are issuable only in a form whereby interest is payable to registered Bondholders or their assigns, the Insurance Trustee shall disburse interest to a Bondholder as aforesaid only upon presentation to the Insurance Trustee of proof that the claimant is the person entitled to the payment of interest on the Bond and delivery to the Insurance Trustee of an instrument of assignment, in form satisfactory to the Insurance Trustee, duly executed by the claimant Bondholder or such Bondholder's duly authorized representative, transferring to Ambac all rights under such Bond to receive the interest in respect of which the insurance disbursement was made. Ambac shall be subrogated to all the Bondholders' rights to payment on registered Bonds to the extent of the insurance disbursements so made.

In the event the trustee or paying agent for the Bonds has notice that any payment of principal of or interest on a Bond which has become Due for Payment and which is made to a Bondholder by or on behalf of the Issuer of the Bonds has been deemed a preferential transfer and theretofore recovered from its registered owner pursuant to the United States Bankruptcy Code in accordance with a final, nonappealable order of a court of competent jurisdiction, such registered owner will be entitled to payment from Ambac to the extent of such recovery if sufficient funds are not otherwise available.

As used herein, the term "Bondholder" means any person other than the Issuer who, at the time of Nonpayment, is the owner of a Bond or of a coupon appertaining to a Bond. As used herein, "Due for Payment", when referring to the principal of bonds, is when the stated maturity date or a mandatory redemption date for the application of a required sinking fund installment has been reached and does not refer to any earlier date on which payment is due by reason of call for redemption (other than by application of required sinking fund installments), acceleration or other advancement of maturity; and, when referring to interest on the Bonds, is when the stated date for payment of interest has been reached. As used herein, "Nonpayment" means the failure of the Issuer to have provided sufficient funds to the paying agent for payment in full of all principal of and interest on the Bonds which are Due for Payment.

This Policy is noncancelable. The premium on this Policy is not refundable for any reason, including payment of the Bonds prior to maturity. This Policy does not insure against loss of any prepayment or other acceleration payment which at any time may become due in respect of any Bond, other than at the sole option of Ambac, nor against any risk other than Nonpayment.

In witness whereof, Ambac has caused this Policy to be affixed with a facsimile of its corporate seal and to be signed by its duly authorized officers in facsimile to become effective as its original seal and signatures and binding upon Ambac by virtue of the countersignature of its duly authorized representative.

President



Secretary

Effective Date:

Authorized Representative

UNITED STATES TRUST COMPANY OF NEW YORK acknowledges that it has agreed to perform the duties of Insurance Trustee under this Policy.

Authorized Officer



Endorsement

Ambac Assurance Corporation
c/o CT Corporation Systems
44 East Mifflin Street, Madison, Wisconsin 53703
Administrative Office:
One State Street Plaza, New York, New York 10004
Telephone: (212) 668-0340

Policy for:

Attached to and forming part of Policy No.:

Effective Date of Endorsement:

In the event that Ambac Assurance Corporation were to become insolvent, any claims arising under the Policy would be excluded from coverage by the California Insurance Guaranty Association, established pursuant to the laws of the State of California.

Nothing herein contained shall be held to vary, alter, waive or extend any of the terms, conditions provisions, agreements or limitations of the above mentioned Policy other than as above stated.

In Witness Whereof, Ambac has caused this Endorsement to be affixed with a facsimile of its corporate seal and to be signed by its duly authorized officers in facsimile to become effective as its original seal and signatures and binding upon Ambac by virtue of the countersignature of its duly authorized representative.

Ambac Assurance Corporation

President



Secretary

Authorized Representative

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